MANAGING THE FEDERAL DIRECT STUDENT LOAN PROGRAM

Y 4.G 74/7:F 31/83

Managing the Federal Direct Student...

HEARING

BEFORE THE

HUMAN RESOURCES AND INTERGOVERNMENTAL RELATIONS SUBCOMMITTEE

OF THE

COMMITTEE ON GOVERNMENT OPERATIONS HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

JUNE 10, 1993

Printed for the use of the Committee on Government Operations

AUG 3 1994

U.S. GOVERNMENT PRINTING OFFICE

79-703 CC WASHINGTON : 1994

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-044439-X

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MANAGING THE FEDERAL DIRECT STUDENT LOAN PROGRAM

THURSDAY, JUNE 10, 1993

HOUSE OF REPRESENTATIVES,
HUMAN RESOURCES AND
INTERGOVERNMENTAL RELATIONS SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:30 a.m., in room 2247, Rayburn House Office Building, Hon. Edolphus Towns (chairman of the subcommittee) presiding.

Present: Representatives Edolphus Towns, Donald M. Payne, Steven Schiff, Stephen Horn, John L. Mica, and Bernard Sanders.

Also present: Ronald A. Stroman, staff director; Allegra A. Pacheco, professional staff member; Martine M. DiCroce, clerk; and Martha Morgan, minority professional staff, Committee on Government Operations.

OPENING STATEMENT OF CHAIRMAN TOWNS

Mr. TOWNS. The Committee on Government Operations, Human Resources and Intergovernmental Relations Subcommittee will convene.

Our first panel of witnesses this morning, are the Honorable Robert E. Andrews, Democrat, from the State of New Jersey, Representative Goodling, from the great State of Pennsylvania, and Representative Petri, from Wisconsin.

I would like to begin with you, Congressman Goodling.

Mr. SCHIFF. Mr. Chairman, one quick second. I want to go straight to the Members because they have other commitments.

I just want to take 1 minute to say that I appreciate very much you having this hearing. I think that it is on a subject that is sensitive because the administration is advocating this change. But I think it is important that Congress closely scrutinizes all proposals from the administration, whether the President is a Democrat or Republican.

And speaking for myself, as a member of the opposite party, I don't think that I should oppose automatically the President's stand on this.

Mr. TOWNS. What I would like to do is give other Members an opportunity for opening statements as well.

Mr. Horn.

Mr. HORN. Mr. Chairman, I would like to say that I think this is a crucial piece of legislation. I think the suggestion of a loan program and the possibility that it would be collected by the Internal

Revenue Service is about three decades overdue if we are going to meet the needs of many people, not just 17 to 22 year olds but individuals on a lifetime basis who could acquire new skills from education—public and private. I think we need to be supportive of this approach.

Mr. TOWNS. Mr. Mica.

Mr. MICA. Mr. Chairman, I am open and receptive to this type of hearing. But I might tell you that my district is next to Fantasy World in Florida, and I have a difficult time believing that the Federal Government can undertake any kind of a program like this better than the private sector. Thank you.

Mr. TOWNS. Thank you very much.

Let me apologize for starting late. We have to vote around here and at the time when we were supposed to start, a vote was called.

Before we go right to our witnesses, let me say that today the subcommittee is examining the Department of Education's plan to implement the President's direct student loan proposal which passed the House as part of the Budget Reconciliation Act and is currently pending approval in the Senate.

I applaud the administration for its attempt to bring under control one of the most badly managed programs in the Federal Government—student lending. Numerous reports have documented widespread fraud, waste, abuse, and pervasive patterns of mismanagement in the existing Guaranteed Student Loan Program.

In December 1992, the Guaranteed Student Loan Program was identified by the GAO as 1 of 17 high-risk programs, especially vulnerable to waste, fraud, abuse, and mismanagement. GAO has also made it clear that the existing loan program and the Department's mismanagement of it have contributed to $2.7 billion in loan defaults last year. This year, more than half of the Federal cost of running the student loan program will be spent repaying defaulted loans.

These extraordinarily high default rates mean that most of the Federal Government's funding for student loans is not going to benefit students. This has operated to the detriment of the education, training, and skill of our students, and ultimately, to America's productivity.

This morning we will begin to carefully review the Department's plans to correct these existing management problems and how it will implement the additional responsibilities of managing a direct lending loan program.

As GAO has pointed out, the inventory of known problems in the Department's administration of guaranteed student loans raises questions about its ability to adequately manage a direct lending program.

As I indicated, we have with us this morning Congressman Bill Goodling from the 19th Congressional District in Pennsylvania. Congressman Goodling is a ranking Republican member on the Committee on Education and Labor and has been very active in these kinds of issues. He is a ranking member on the Subcommittee on Elementary, Secondary and Vocational Education. Congressman Goodling is also a member of the Foreign Affairs Committee.

We welcome you to the subcommittee. You may proceed.

[The opening statement of Mr. Towns follows:]

OPENING STATEMENT OF CHAIRMAN EDOLPHUS TOWNS

DIRECT STUDENT LOAN PROGRAM

JUNE 10, 1993

Today this subcommittee will examine the Department of Education's management planning to implement the President's direct student loan proposal, which passed the House as part of the Budget Reconciliation Act, and is currently pending approval in the Senate.

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STATEMENT OF HON. WILLIAM F. GOODLING, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. GOODLING. Thank you, Mr. Chairman.

I, too, am pleased that you are having this hearing. Every time we make policy decisions like this in reconciliation, we live to regret what we have done. Whenever you legislate in reconciliation, you can get into serious trouble.

I have observed and been a part of this program for 19 years. After careful consideration in our committee, both the subcommittee and the full committee, last year in the reauthorization of the higher education program, we indicated that we better step softly and by a pilot direct lending program before we end up throwing the baby out with the bath water. I think that was very prudent and continues to be the direction we should go.

Unfortunately, in reconciliation we have reversed this direction. It is with some reluctance that I testify, because, of course, in testifying on this subject you have to get into some negative issues because you have to discuss the Department's inability to manage their programs up to this point. We have an awful lot of dedicated people in the Department. Nevertheless, we do have to look at the reports that we have received. The reports are not good. And I don't have to tell you, that we all hear criticism on the floor of the House almost daily about any program that the Federal Government has tried to run and they have turned out to be a disaster.

You have many educational institutions, students, and others knowledgeable about student loans that are concerned that if the Department fails to administer a direct loan program properly, students, their parents, and educational institutions will be hurt. Last year the General Accounting Office directly addressed the issue of the Department's administrative capabilities. They noted, "the inventory of known problems in the Department's administration of guaranteed student loans raises questions about its ability to adequately manage a direct lending program."

The GAO raised questions about whether the Department is adequately managing its existing multibillion dollar program and noted that, one, the Department lacked controls to adequately manage the existing multibillion dollar student assistance programs, and, two, problems erupting from these programs could eventually overwhelm any potential reform measures.

To show you the magnitude, let me tell you about one of the programs that is known as a model program, the Pennsylvania Higher Education Assistance Agency [PHEAA]. Just to show you what the magnitude of this program is that we are talking about, last year PHEAA handled approximately 519,000 applications. They guaranteed $1.7 billion in GSL volume. They serviced 6.9 billion in GSL volume. They had an administrative budget for GSL-related activities of $66.9 million. They employed 1,697 people. And they served as the designated guarantor for Pennsylvania and West Virginia.

And I think everyone that I have ever talked to would say that they are a rather ideal model, and no one has any complaints about the way they have run the program. But I just want to show you the magnitude. This is one higher educational assistance agency guaranteeing a certain number of loans, and the number of people they employ, the cost involved, et cetera.

In order to give you the kind of information used in evaluating a move to direct lending, I asked myself six questions.

One: Is the Department prepared to manage the data processing requirements inherent in a direct loan program?

The Department has suggested direct lending will seek to make student loans simple to administer and use. This will entail establishing a data exchange system that will enable students and schools to get and exchange information on student loans through a single source. Unfortunately, the Department clearly does not have the expertise or the means of operating such a system.

The Labor, HHS-Education Subcommittee on Appropriations has noted, "slow progress of the Department in developing a computer system authorized in 1986, the National Student Loan Data Base."

As you may know, this data system is necessary to enforce eligibility rules. They can't, at the present time, tell us which schools are eligible and which aren't and who is participating that is not eligible. I'm referring to the national student loan data bases, as you may know, a system that is necessary to enforcing eligibility rules as well as statutory loan limits and other student aid.

The Appropriations Committee also noted the systemic vulnerabilities in the structure of the student aid programs and the Secretary's administration of these programs.

These examples demonstrate that the record of the Department in management data systems is not a good one. The last Secretary and Mr. Carnes were trying to improve—and this Secretary wants to continue that—the administrative capabilities of the Department of Education. But we are a long way from there. That is why the pilot programs seem to be the direction that we should be moving in.

Two other recent GAO studies suggest that the Department does not have the experience necessary to manage its own system and is not prepared to manage a third-party contractor of such a system.

First, a 1990 GAO report noted the Department is running a multibillion dollar commercial loan operation with a data system that contains incomplete, inaccurate, unreliable information. It does not have accurate systems of internal control to assure that Federal assets are safeguarded against waste and loss.

In 1992, the GAO report noted the Department lacks proper systems and controls to adequately manage its multimillion student assistance programs. The Department's student loan information systems contain data that are not always useful, timely, or accurate, thereby limiting their use for compliance and evaluation purposes.

A recent incident casts doubt on the Department's ability to manage a comprehensive data processing system.

The Department's central processor sent thousands of confidential financial aid forms to the wrong school. The Department said this error resulted from a decision to save money by not printing a supplemental form that has been routinely distributed with the form in prior years. Apparently, the expertise did not exist at the Department to foresee the possibility of problems created by not using the form.

My second question: Does the Department have the financial management expertise necessary to assure sound program management of direct loans?

There is overwhelming evidence that the Department is not prepared to administer these monthly accounting functions under the direct loan program. These functions, however, are critical to the program's viability. If adequate safeguards are not in place from the beginning, the program could be subject to considerable abuse.

Under the administration's proposal, institutions will either be authorized to originate direct loans themselves, or they will work with a designated third-party loan originator under contract to the Department of Education.

If the school originates loans directly, requests for funding will be sent electronically to the Department which will wire funds to the school. The institution will, in turn, disburse funds to the student only after receiving a completed loan application promissory note.

Finally, the school will reconcile its escrow account 30 days after the end of the month in which the loan was disbursed.

This is a very complicated program, and that is why I keep going back to the same conclusion—we should first do the pilot program, authorized last year in the committee.

A March 1993 GAO report noted that the Department did not have reliable and timely data on which to base its estimate of the future cost of outstanding guaranteed loans. The GAO estimated that the cost could have exceeded $10 billion by September 30, 1991.

Education developed its estimate of $6.1 billion using a model based on an analysis of data which were not reliable and a number of other assumptions about the program and the economy, some of which were not reasonable. In addition, significant unreconciled differences existed between financial information recorded in the Department's general ledger, subsidiary systems, and Treasury reports.

More directly put, the GAO noted, education's internal accounting controls over the student loan program did not reasonably ensure that integrity and reliability of its financial management reports were possible.

The third question I ask: Will the direct loan program be subject to increased default and other losses resulting from poor oversight over eligible institutions?

Under the current guaranteed loan program, a large proportion of the audits and program review of schools are performed by guarantee agencies. This safeguard of Federal funds would be lost under the direct loan program.

Under direct loans, any school determined to be eligible to participate in the program would have virtually unlimited access to student loan funds. While easier access to funds for needy students attending quality schools is desirable, under direct loans, some less-than-quality schools will find it easier to pick the Federal pocket.

Will the Department do a better job than it has in the past in protecting students from the abusive schools?

I certainly hope so. And I also believe that progress is being made. Unfortunately, however, the Department's past performance in the area of institutional eligibility certification and oversight is horrendous.

The litigation against the Department has generally been brought by schools who believe that their published default rate is higher than actual experience at the school or that the Department of Education included loans that had not been adequately serviced. In some cases, millions of dollars of loans were made available to a school that was subsequently discovered to have a default rate well above the minimum level specified in the Higher Education Act.

Perhaps the most damning assessment of the Department's ability came from the Department of Education's own inspector general, James Thomas, Jr., who, before the Nunn committee, testified that an audit issued in 1989 disclosed that the Department's financial analysis certification procedures were not adequate to protect students or the interest of the Federal Government.

Let me quickly go on, and you can read——

Mr. TOWNS. Your entire statement will be included in the record, as you know.

Mr. GOODLING. I am emphasizing some of these things, because I want to be sure that you understand the magnitude of what it is that we are doing because I may be the only person here to testify about that. And so that is why I am trying to point out some very specific possibilities where trouble can arise.

The fourth question was: Does the Department have the overall management capability to run the program?

Well, the most dramatic example of problems in the proposed bill is the claim that the administration would lower borrowing rates by one-half of 1 percent starting in fiscal year 1997.

In 1997, the legislation calls for the borrower interest rate to be based on a security with comparable maturity. A quick review of the Wall Street Journal suggests that the last auction of U.S. securities shows an increase, not a decrease in borrower interest rates would result. If the administration's proposed interest rates formula were in place today, Stafford loan borrowers would be paying three-fourths of 1 percent higher than under current law. Again, another reason why we have to be careful.

The Perkins loan programs, currently administered by the Department, most closely parallels many features proposed for direct lending. And I invite you to review the record of that program.

The fifth question: Would shortcomings at the Department adversely impact the default experience under the new program?

As you know, Mr. Chairman, the administration asserts that there would be no increase in defaults under direct loans, notwithstanding the fact that the government has a poor record—I emphasize that—in collecting debts owed to it.

The Congressional Research Service has suggested that the default experience under the direct loan program could indeed increase. CRS notes such a direct loan system has a high potential to have a higher default rate even when compared to a guarantee program.

My final question: Would the Department be able to adequately project necessary loan volume?

And I already touched on that and said they haven't been able to do it with Pell. They haven't done it with student loans. And I don't know how, all of a sudden, with a direct loan program, they would be able to do that. I am concerned that the entitlement funds from the direct loans would be threatened if the Department does an equally poor job.

I would conclude by saying that I think it is very interesting that the colleges and universities that support direct lending without going through a pilot program to see whether it can be effective or not, probably don't understand reconciliation in the House of Representatives. I do. I know what we do in reconciliation, just as we do here. We automatically say there will be x number of dollars saved. What did we do in Medicare? We say we won't attack those receiving; we will hit the providers. Who are we kidding? Somebody has to pay what Medicare doesn't pay, and you know who that is. You and I pay.

So what will happen down the line when the Budget Committee says, well, you are going to have to come up with x number of dollars of savings; and we will say, let's look at the colleges and universities.

Then they are going to be down here screaming, hey, why didn't you do the pilot program? So again, I think you are doing a great disservice to the institution, first of all—because it is this institution that will suffer if we don't do well—by having this hearing.

And again I just plead that we go the route of the pilot program and make sure that we know what we are doing, because if we aren't successful and we have eliminated all those who are responsible for providing the existing program, then we have nothing.

So, again, thank you for having the hearing.

[The prepared statement of Mr. Goodling follows:]

TESTIMONY OF

CONGRESSMAN WILLIAM F. GOODLING

RANKING REPUBLICAN MEMBER OF THE

EDUCATION AND LABOR COMMITTEE

TO

HOUSE GOVERNMENT OPERATIONS COMMITTEE

HUMAN RESOURCES AND INTERGOVERNMENT

RELATIONS SUBCOMMITTEE

JUNE 10, 1993

Mr. Chairman, thank you for the opportunity to testify today on the Department of Education's ability to administer a direct student loan program.

I must admit I accepted the Subcommittee's invitation to testify today with some reluctance. The subject of the administrative capability of the Department creates an expectation that the testimony will be negative. I for one, am reluctant to criticize the Department, where there are numerous hard-working, competent and creative civil servants. I also know that the new Secretary is continuing the commitment which began under Secretary Alexander to raise the overall quality of the management capability of the Department. I know we all will support him in this effort.

Unfortunately, however, the Congress is now being asked to dramatically expand the role of the Department in the single largest student assistance program--student loans at a time when their management abilities are being seriously questioned.

Many educational institutions, students, and others

knowledgeable about student loans are concerned that if the Department fails to administer a direct loan program properly students, their parents, and educational institutions will be hurt.

I congratulate Chairman Towns, Ranking Member Schiff, Congressman Payne, and Craig Washington who sit on the Education and Labor Committee with me, and the other Members of the Subcommittee for holding this hearing. I hope that the testimony received will be used both to evaluate the Department's administrative abilities as well as to help guide improvements at the Department.

Late last year the General Accounting Office (GAO) directly addressed the issue of the Department's administrative capabilities. The GAO noted: "the inventory of known problems in the Department's administration of guaranteed student loans raises questions about its ability to adequately manage a direct lending program." More importantly, the GAO raised questions about whether the Department was properly managing its existing multi-billion dollar programs. The GAO observed that the Department, "lacks proper systems and controls to adequately manage its multibillion dollar student assistance programs, and problems erupting from these programs could eventually overwhelm any potential reform measures."

The GAO findings echoed those of the Senate Permanent Subcommittee on Investigations chaired by Senator Sam Nunn. In its report on fraud and abuse in the federal student assistance programs, the Subcommittee noted:

> "The Subcommittee's investigation revealed that the Department of Education has failed to efficiently or effectively carry out it's [student loan] responsibilities. Virtually every witness described instances of gross mismanagement, ineptitude, and/or neglect in the Department's performance of its [student loan]-related regulatory and oversight functions."

It was partially on the basis of the GAO's and other assessments of the Department's preparedness to run a direct lending program that I oppose the Administration's proposal.

In reaching my conclusion that the Department currently lacks the administrative capability to administer a direct loan program, I asked myself six basic questions, that I would like to review:

1. **Is the Department prepared to manage the data processing requirements inherent in a direct loan program?**

The Department has suggested that it will seek to make direct loans simple to administer and use. This will entail establishing a data exchange system that will enable students and schools to get and exchange information on student loans through a single source. Unfortunately the Department clearly does not have the experience or the means of operating such a system.

The Labor, HHS-Education Subcommittee on Appropriations has noted the "slow progress of the Department in developing a computer system authorized in 1986--the National Student Loan Data Base." As you may know, this Data System is necessary to enforce eligibility rules, as well as statutory loan limits and prohibitions against defaulters receiving additional Federal student aid. The Appropriations Committee also noted the "systemic vulnerabilities" in the structure of student aid programs and the Secretary's administration of these programs.

These examples demonstrate that the record of the Department in management data systems is not a good one.

Two other recent GAO studies suggest that the Department does not have the experience necessary to manage its own system and is not prepared to manage a third-party contractor of such a system.

First, a 1990 GAO report noted: "The Department is running

a multibillion dollar commercial loan operation with a data system that contains incomplete, inaccurate, unreliable information. It does not have accurate systems of internal control to assure that federal assets are safeguarded against waste and loss . . ."

Second, a December 1992 GAO report noted, "The Department lacks proper systems and controls to adequately manage its multimillion student assistance programs . . . . .. The Department's student loan information systems contain data that are not always useful, timely or accurate, thereby limiting their use for compliance and evaluation purposes."

A recent incident casts doubt on the Department's ability to manage a comprehensive data processing system. The Department's central processor sent thousands of confidential financial aid forms to the wrong school. The Department said this error resulted from a decision to save money by not printing a supplemental form that has been routinely distributed with the form in prior years. Apparently, the expertise did not exist at the Department to foresee the possibility of problems created by not using the form.

2. My second question was, **Does the Department have the financial management expertise necessary to assure sound program management of direct loans?**

Under the Administration's proposal, institutions will either be authorized to originate direct loans themselves or will work with a designated third party loan originator under contract to the Department of Education. If the school originates loans directly, requests for funding will be sent electronically to the Department, which will wire funds to the school. The institution will in turn disburse funds to the student only after receiving a completed loan application/promissory note. Finally, the school will reconcile its escrow account thirty days after the end of the month in which the loan was disbursed.

There is overwhelming evidence that the Department is not prepared to administer these monthly accounting functions under the direct loan program. These functions, however, are critical to the program's viability. If adequate safeguards against abuse are not in place from the beginning, the program could be subject to considerable abuse.

Consider the following:

--A March, 1993 GAO report noted that "The Department did not have reliable and timely data on which to base its estimate of the future cost of outstanding guaranteed loans. The GAO estimated that the cost could have exceeded $10 billion by September 30, 1991. Education developed its estimate of $6.1 billion using a model based on an analysis of data which were not

reliable and on a number of other assumptions about the program and economy some of which were not reasonable. . . . In addition, significant unreconciled differences existed between financial information recorded in the Department's general ledger, subsidiary systems, and Treasury reports." More directly put, the GAO noted, "Education's internal accounting controls over the [student loan program] did not reasonably ensure the integrity and reliability of its financial management reports."

On the basis of this, I do not believe it is prudent to ask the Department to assume loan administrative responsibility for a $20 billion a year student loan program.

3. My third question was, **Will the direct loan program be subject to increased defaults and other losses resulting from poor oversight over eligible institutions?**

Under the current guaranteed loan program, a large proportion of the audits and program reviews of schools are performed by guarantee agencies. This safeguard of federal funds would be lost under the direct loan program.

Under direct loans any school determined to be eligible to participate in the program would have virtually unlimited access to student loan funds. While easier access to funds for needy students attending <u>quality</u> schools <u>is</u> desirable, under direct

loans some less than quality schools will find it easier to pick the Federal pocket.

Will the Department do a better job than it has in the past in protecting students from abusive schools? I certainly hope so, and I also believe progress is being made. Unfortunately, however, the Department's past performance in the area of institutional eligibility, certification and oversight is horrendous.

The Department has been successfully sued by several institutions over faulty cohort default rates. Notwithstanding the fact that the practice of calculating default rates to eliminate high default rate schools from the program is now in its 5th year. The Department has yet to adequately assure the quality of cohort default rate data so as to avoid such litigation.

The litigation against the Department has generally been brought by schools who believe that their published default rate is higher than actual experience at the school or that the Department of Education included loans that had not been adequately serviced. In some instances, however, the Department's errors go in the other direction. In one well publicized case, millions of dollars of loans were made available to a school that was subsequently discovered to have a default

rate well above the minimum level specified in the Higher Education Act.

The Department of Education has delegated a major portion of the responsibility for oversight of schools to guaranty agencies, which now perform most of the program reviews and have been involved in many of the limitation, suspension, and termination procedures. When these entities are disbanded or are forced to reduce their levels of activity, will the Department of Education have to undertake these functions?

Perhaps the most damning assessment of the Department's ability came from the Department of Education's Inspector General James B. Thomas, Jr., who before the Nunn Committee testified that "An audit issued in 1989 disclosed the Department's financial analysis certification procedures were not adequate to protect students or the interest of the federal government."

There is no evidence convincing me that this basic underlying problem regarding the Department's ability to oversee the expenditure of federal monies has been solved or even adequately addressed. The elimination of guaranty agencies that have greatly assisted the Department in assuring that Federal monies involved in the student loan program are spent for the purposes for which they are intended gives me great hesitation.

I seriously question whether the Department is prepared to take on these new responsibilities, notwithstanding the very substantial increases in authority in audit requirements included in the 1992 amendments to the Higher Education Act.

4. My fourth question was, **Does the Department have the overall management capability to run the program?**

Going beyond any particular programmatic expertise is the question of whether the Department has the overall management expertise necessary to design, implement, and operate a direct loan program. The most tangible evidence of the Department's record in this regard is the direct loan legislation submitted to the Congress in April. A detailed critique of this legislation is far beyond the scope of this hearing. However, I must note that the legislation submitted to Congress has very few operative parameters, calls for a suspension of the General Education Provisions Act (GEPA) so as to allow regulations to be issued without community review, and otherwise had several provisions which, to my mind simply do not make sense.

The most dramatic example of problems in the proposed bill is the claim that the Administration would lower borrower interest rates by 1/2 of a percent starting in fiscal year 1997. In 1997 the legislation calls for the borrower interest rate to be based on a "security with comparable maturity". A quick

review of the Wall Street Journal suggests that the last auction of U.S. Treasury securities prior to June 1st shows an increase not a decrease in borrower interest rates would result. If the Administration's proposed interest rates formula were in place today, Stafford loan borrowers would be paying the rate 3/4 of a percent rate higher than under current law; SLS borrowers would be paying a rate of more than 8/10 of a percent higher; and parent borrowers would be paying 1.4 percent more.

It is unclear to me whether the Administration simply did not understand what they were proposing or whether the economic projections used by the Department suggest that somehow in FY 1997 the interest rate formula would indeed produce lower borrower interest rates.

The Perkins Loan program is the student aid program currently administered by the Department that most closely parallels many features proposed for direct lending. While the Department expects to improve its administrative capabilities to operate the direct loan program, its historical record in administering the Perkins Loan program is far from stellar. The Perkins program has been plagued by huge default rates, which required the government to purchase many bad loans, by delays in getting funds to institutions, and by mismanagement of federal capital contributions at the campus level.

5. My fifth question was, **would shortcomings at the Department adversely impact the default experience under the new program?**

As you know Mr. Chairman, the Administration asserts that there would be no increase in defaults under direct loans, not withstanding the fact the government has a poor record in collecting debts owed to it. The Congressional Research Service (CRS) has suggested that default experience under the direct loan program could indeed increase. CRS notes "such a (direct loan system has a high potential to have a higher default rate even when compared to a guaranty program with no default scoring." This would result from the Department not managing loan servicing and collection less effectively and efficiently from the Department. Historically, the Department has collected loans less effectively than the guaranty agencies even though they are both used the same third party collectors.

6. My final question was, **would the Department be able to adequately project necessary loan volume?**

The direct loan program will entail the Departments of Treasury and Education making available to education institutions, directly and through alternative originators, a sufficient amount of funds in a timely fashion so as to allow loans to be made to students. This will require adequate advance planning in the sale of treasury securities amounting to more

than $100 billion during the first 5 years of full implementation of the program, and also accurately projecting loan volumes demands. The Department of Education's recent experience in the Pell Grant program is telling. For each of the past 5 years the Department has made major errors in assessing the necessary volume of Pell grants for the coming academic year. This has contributed to reductions in the maximum grant as called for in the 1992 Higher Education Amendments and under prior law. As you know Mr. Chairman, the Pell Grant Program currently suffers a shortfall of approximately $2 billion. In face of this shortfall, the maximum grant for this coming academic year, 1993-94, had to be reduced from $2400 to $2300, well under the authorized level of $3,700.

I am very concerned that the entitlement to funds from direct loans will be threatened if the Department does an equally poor job in projecting the demand for direct loans.

Conclusion

Mr. Chairman, there is significant evidence that suggests that the Department is not running the current student financial aid programs very well. The necessary increases in administrative responsibilities inherent in direct loans suggests that the Department will be overtaxed. I fear these new responsibilities will create a significant risk of an overall

management breakdown. It must not be forgotten that the Department will be asked to run two programs simultaneously -- the phase-down of the current Federal Family Education Loan program and the phase-in of the Federal Direct Student Loan program.

The phase-down of the current program by itself may prove to be an insurmountable management task for the Department in that it is very likely to involve the insolvencies of two dozen or more guaranty agencies and the need for the Department to act in assuring continued loan access to students who may find it difficult to secure student loans during this transition period.

I believe it would be reckless for the Congress to proceed with direct loans until some measurable improvement in the Department's management ability is demonstrated. It makes far more sense to first test the concept of direct lending. We agreed to a significant sized pilot in last year's reauthorization of the Higher Education Act, I hope that we can give that pilot an opportunity to get started and learn from it while giving the Department an opportunity to continue to address its management deficiencies.

Mr. Chairman, thank you for the opportunity to testify before you today, I would be pleased to respond to any questions that you may have.

Pennsylvania Higher Education Assistance Agency (PHEAA)
and the
Guaranteed Student Loan Program

In Academic Year 1991-92, PHEAA:

- processed 519,000 GSL applications.
- guaranteed $1.7 billion in GSL volume.
- serviced $6.9 billion in GSL volume.
- had an administrative budget for GSL related activities of $66.9 million.
- employed 1,697 people.
- served as the designated guarantor for Pennsylvania and West Virginia.

Mr. TOWNS. Thank you very much Congressman Goodling. I hope that you will be able to stay.

Mr. GOODLING. Yes, if my chairman doesn't start screaming. I am supposed to be in his office at 11 o'clock.

He is my chairman.

Mr. ANDREWS. I would be happy to defer so Mr. Goodling could take questions.

Mr. TOWNS. I will yield to any questions for Congressman Goodling.

Mr. SCHIFF. I just have one question.

You emphasized the need to test in a pilot program. I am not quite clear. Do we have a pilot program now? I believe we do.

Mr. GOODLING. Yes, we authorized a rather large pilot program in last year's reauthorization of the Higher Education Act so that we could get small institutions, medium, and larger institutions involved.

Unfortunately, it won't move for another year and we are already talking about just jumping in totally.

Mr. SCHIFF. So we have never actually implemented the pilot program?

Mr. GOODLING. No. It is sitting there ready to go.

Mr. SCHIFF. Thank you, Mr. Chairman. I yield back.

Mr. TOWNS. Any other members?

Mr. Horn.

Mr. HORN. In your idea of a pilot program, what time period do you see to test that? How many institutions would you suggest be involved?

Would they be on a regional basis?

Mr. GOODLING. As I indicated, we made—because of the efforts of the gentleman to my right, we made the pilot program quite large so that we covered all regions, and all sizes of institutions. We started out with 200 institutions.

If you are in the business of having all sorts of money coming to your institution and you are dealing with that, you probably can do some of this without too much trouble.

Most institutions are not in that position, and they don't have that kind of endowment to support administrative functions.

Mr. HORN. Are you thinking of a 2-year program?

Mr. GOODLING. I think it is over in 1997.

Mr. HORN. A 5-year program.

Mr. GOODLING. Yes. This isn't anything new.

Mr. Petri has had this on the table for 10 years.

Mr. PETRI. Twelve.

Mr. GOODLING. Twelve. Excuse me.

And Mr. Andrews has had it on the table for 2 or 3 years. So it isn't anything new. But we finally got to the pilot program, which I think is the route we should go.

Because, as I said, our past history with the Federal Government and direct lending from both sides of the aisle has been condemned. You can read pages in the Congressional Record, the condemnation of the direct lending by the Federal Government.

Mr. TOWNS. Congressman Mica.

Mr. MICA. Just thank you, Mr. Goodling. As a skeptic, you have confirmed my worst suspicions. Thank you.

Mr. GOODLING. Well these two gentlemen will take those terrible suspicions away.

Mr. TOWNS. Thank you for coming and joining us. Thank you very much.

Congressman Andrews.

STATEMENT OF HON. ROBERT E. ANDREWS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. ANDREWS. Thank you, Mr. Chairman. And thank you for this opportunity to be here this morning.

And I think Mr. Goodling's testimony was offered in the spirit of identifying real and legitimate administrative problems for this idea. And I know this hearing is put forward in the same spirit. I appreciate that, and I speak on behalf and in support of the administration's bill and in support of the idea of direct lending.

There has been a great deal of testimony and a great deal of speech making and a great deal of letter writing in opposition to an immediate change in a student loan program nationalized and run by the Federal Government. And well there should be, because direct lending is not an immediate change. It is not the nationalization of the student loan program, and it would not be run by the Department of Education. If it was going to be like that, the bill that was before us today, I would join those who are skeptics. But that is not what is before us. I would like to talk about what direct lending isn't and is and why we are having such a debate as we are having over this in the Congress.

Direct lending is not the nationalization of student loan programs. Section 457 of the bill that several of us introduced that is now part of reconciliation supported by the administration calls for the Secretary of Education to contract out, on a competitive basis, the responsibility and obligation to collect and service the loans that would be made to students around the country.

Who would collect the loans? The most competent, qualified, competitive bidder would collect the loans under that system.

Who would originate the loans? Would they be originated by the Department of Education? No, they would not. In the case of schools that were judged to be competent to originate their own loans and who were willing and volunteered to do so, the schools themselves would originate the loans as they originate Pell grants and Perkins loans.

The difference between direct lending and guaranteed lending is basically this: Instead of the taxpayer guaranteeing the loan, the Federal Treasury is the original source of the loan. Are the taxpayers bearing a greater risk of default? Marginally.

Under the present system, it is estimated that the taxpayer is bearing 93 percent of the risk. And in this system, it would be 100 percent. We believe it might be a lower default cost because of some of the changes in approvals.

Is this an immediate overnight change? I listen to the critics of direct lending, and sometimes you get the impression that the next academic year every school in America will be radically changing the way it does student loans. That is not the case. The bill phases in over a gradual 5-year period. In the first year, only 4 percent of the institutions in the country would be participating in the pro-

gram. In the second year, 29 percent; and in the third year, slightly over half of the institutions would be participating in the program.

Is it the nationalization of the program? No.

Would the Department of Education be collecting the loans? No.

Would it be an overnight change away from a system that we have now? No.

Is the system that we have now something that works with great efficiency and productivity? Well, it depends upon your point of view. I would suggest that some of the Members might want to go back to their districts and have some students who are paying their loans tell them what they think of the vaunted efficiency and the lack of complication under the present system.

Students must deal with a multiplicity of banks, grant agencies, collection agencies, lots of other players in the present system. If you think the present system is streamlined, efficient, simple, and easy to deal with, ask your students in your district; ask your students what they think about the present system.

What is direct lending? It is the very basic idea that taxpayers of this country have not been paying someone else 8 percent interest on money that we could borrow at 3½ percent interest. That is the very basic idea there. It is a franchise granted by the present system to banks and other lenders in the system that gives them the right to collect cash-flow from the Federal Treasury on money that apparently is supposed to leverage their administrative expertise on money that we could borrow at a much, much lower rate than they are presently borrowing under the system.

The GAO said that we could save $1.3 billion per year or more if we were to switch to the system of direct lending.

Does the administration count on a savings of $1.3 billion per year? No, it does not. As a matter of fact, the savings that are contained in the reconciliation contain savings estimates that are considerably lower and more conservative and less optimistic about the generation of savings than has been called for by the GAO.

Is direct lending a perfect system that will work that we are absolutely sure of? Of course it is not. That is why it is being phased in over a 5-year period. That is why no school would be compelled to be a part of it. And that is why the Department of Education is not required to immediately initiate an overnight collection system. That is why the bill calls for a marriage of what we think is the best of the public sector, the cheaper cost of acquiring capital with the best of the private sector, the efficiencies to be gained on a competitive basis.

Why is there such heat and furor over this issue? If it works, direct lending is a transfer of income, over $1 billion a year, from an industry that has grown up around the program to students. It is a transfer of $1 billion a year from banks and secondary markets and guarantee agencies that are siphoning off $1 billion a year from the Federal Treasury to students. That is what the fury and sound is all about.

Gentlemen, ladies, we have seen this before. The Defense Department orders an airplane that won't fly or a ship we don't need, a vehicle that won't work; and as soon as someone criticizes it, all the people that have vested interests in building it flock to Capitol Hill. What do they say? They don't say, don't take away our Fed-

eral subsidy; what they say is, the national security depends upon building this plane or making this ship or making something go forward.

This is the same argument. This is an airplane that does not fly. Our program and the administration's program calls for this to be phased in over a 5-year period. There will certainly be administrative difficulties. The savings may not be as high as the GAO says, although many of us believe that it will be. But anybody who wants to defend the efficiency of the present system, the cost savings of the present system, in my opinion, must carry the burden of showing that this idea will not work.

We are prepared to carry the burden of showing that it will. And we urge the members of the subcommittee to look carefully at the idea and lend it their support.

Mr. TOWNS. Thank you very much, Congressman Andrews.

Congressman Petri.

STATEMENT OF HON. THOMAS E. PETRI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. PETRI. Thank you. I appreciate you allowing me to crash this hearing at Rob's invitation, and I want to briefly state a few things.

First of all, I want to commend the President, Secretary Riley, and Under Secretary Kunin for working on this program. I express my strong support for what they are doing as the senior Republican on the Higher Education Subcommittee, to illustrate that this is one example of where the President is bringing us together and getting support from both political parties for a major initiative to try to make government work better, more efficiently, and serve people who deserve to be served well—young people and students and taxpayers at the same time—by developing a more efficient program with the money focused on where it should be going, rather than being dissipated in overhead.

I would just make a few brief points. A lot of the people who are expressing the need for studying this and how we ought to look at a pilot program, have been fighting for the last 12 years to have a pilot program. They don't want any change. And if there is to be a change, they want it to be as slow and grudging as possible. They didn't fight to get a pilot program, but they are now clutching at that as one means of possibly delaying it.

I want to commend you, Mr. Chairman, your subcommittee, for having this hearing for focusing on the need to manage this program well. And I hope that this will be a sustained interest and that you will be working closely with the Education Department as they move forward because it is important that they do manage this well. And it certainly is something that I think they will be able to do.

Some say the Education Department is ill equipped to contract out and that banks should be relied on. They have the expertise in this area. You know what banks do? They contract out. They are not experts in data processing. They rely on specialized organizations, and they are the same organizations that the Education Department will contract with.

We don't need to give the banks a subsidy to provide them with the ability to contract out. Why not contract directly and save $500

million in profit? This is something that our society has evolved into. If it won't work, it won't work because the private sector can't supply the expertise. I believe they can. They are doing it for all sorts of organizations, public and private. And I believe that your committee and others working closely with Secretary Riley and his team will be able to devise a good methodology for developing the bidding process and making it work to everyone's interest.

And with that, I want to thank you for having this important hearing.

Mr. TOWNS. Thank you very much, Congressman Petri.

I would like to yield to the ranking member, Congressman Schiff.

Mr. SCHIFF. Thank you, Mr. Chairman.

First of all, I want to congratulate all of our colleagues, all three, for excellent testimony. I have not come to a conclusion in this matter, and I think all three witnesses have been excellent in pointing out the issues.

Therefore, the questions I have may be a little bit like a devil's advocate.

Congressman Andrews, your theoretical statement about why should we pay 8 percent to a bank when we can borrow for 3½ or whatever it might be, is a good theoretical approach. But does it not ignore the history of what happens when government bureaucracies get involved?

And what costs might be incurred there?

Mr. ANDREWS. No. It goes forward with that very much in mind. That is why the bill does not call for the loans to be serviced and collected by a government bureaucracy. It calls for the contracting out of those services by the Department of Education.

The idea behind direct lending is to pass the savings of the Federal Government volume discount borrowing advantage on to students families rather than to have that discount avoided and ignored and wind up creating a needless and expensive subsidy.

I want to repeat that the administration's bill, our bill, does not call for the Department of Education to service and collect the loans. It requires them, directs them, empowers them, to call for the best of the private sector to do that job.

Mr. SCHIFF. The universities I have talked with back in New Mexico have expressed concern. I assume this to be a nationwide concern.

Would this change impose any additional requirements on the universities either in the awarding of student loans or collection of student loans that would impose costs upon them?

Mr. ANDREWS. Yes, it would impose costs on them.

The second part of the answer is that the bill specifically requires the school to allow an administrative allowance to cover those costs as set forth in the bill.

Another clarification that I want to give you, because it is a distortion that is running around, is that somehow the colleges and universities will be required to originate these loans, and they will be the recipient of new legal liability.

The way this bill is written, any institution or university that wishes to originate a direct loan and which has been judged to have the capacity by the Department, will have the right to do so. An institution which chooses not to originate the loan will be given

the option of getting loans for their students originated by an alternative originating entity, whether that would be a higher education assistance authority, an institute, or a consortium in their State, or a bank.

The other point that I want to make clear is that the school is not responsible for collecting the loan and is not liable if the loan is not collected. There has been some information where some schools are under the misperception that that is the case, and it is not.

Mr. SCHIFF. Can I get into the immediate practical aspects of where we are?

You have made several references to the Budget Reconciliation Act. Is this self-executing in the act?

Mr. ANDREWS. It is self-executing in the Budget Reconciliation Act. I regret that. I think there should have been separate legislation. I say that as an advocate of the idea.

But the administration chose to take advantage of the savings of direct lending in the budget reconciliation.

Mr. SCHIFF. If we do get it out as a separate item—and I understand Congressman Petri is questioning the advocacy of a pilot program not being advocated in the past, wouldn't it make sense to try a pilot program and see if there was savings in the program?

Mr. ANDREWS. Yes, it would. That is why we have a pilot program in the system.

At the end of the third year, only slightly over half would have participation in this program.

Mr. SCHIFF. I thank you.

I yield back, Mr. Chairman.

Mr. TOWNS. Mr. Sanders.

Mr. Horn.

Mr. HORN. I would like to hear from each of the witnesses how they feel about collection of the student loans being the responsibility of the Internal Revenue Service from the tax system that these students would participate in through the rest of their lives.

And as I understand, it is not in the initial administration bill. It would have to be a separate action, either an amendment to that bill or later on.

How do you both feel about it? And why are you for it? Or why are you against it? As the case may be.

Mr. PETRI. I strongly support it. And we did get several amendments adopted to the last higher education reauthorization to allow, under certain circumstances, the IRS to collect student loans, either those in default or at the option of a student.

I think having contingent repayment by the IRS makes very good sense for all the parties involved. From the point of view of the borrower, it means they are not in default if they are not earning money right after school. The loan is automatically rescheduled, and they can tell they aren't able to pay by the tax return filed. Default is a bad thing. It is bad for the government and the defaulter because they get a bad credit rating. And later on, when they want to buy a house or start a business, they are behind the eight ball.

And so I think contingent repayment by the IRS will save the taxpayer money. If the money is there, it will be collected; and if it is not there, the loan should be rescheduled.

So I am pushing hard, and we are continuing to work with the new head of the IRS in this administration. She is favorably inclined toward the idea. The IRS is in the midst of a major national effort, which has not been widely heralded, to radically upgrade their computer processing capability. And by the time they are finished, they will be able to do the same as Master Charge and everyone else and keep individual accounts and figure out this sort of thing electronically. And then it will be mechanically feasible as well.

So it is something that should be phased in increasingly over the next 4 or 5 years. And we are working in that direction.

Mr. ANDREWS. I agree with it, too. I think IRS collection is an excellent idea. I wish the bill went further in that direction than it does at present.

What I would like to see happen is to have specific authority for the Secretary of Education, in concert with the IRS, to do this. My prediction is that is where we will be in 5 years, and that is why we should be——

Mr. HORN. Would you accept an amendment on the floor to add to the bill?

Mr. ANDREWS. Conditionally. I would with the proviso that the administrative details be worked on. One of the problems with IRS collection is that IRS collection in payroll withholding obviously comes against wage income only. People have income in other categories, obviously, as well. And there are questions about the complications of reporting and collecting it. But the idea of people making repayment the same way they make their tax payment is good work. And I am sympathetic to such an amendment.

Mr. HORN. Is there any fear of some of the members of your committee that if they involve the IRS they will lose jurisdiction to the Ways and Means Committee.

Mr. ANDREWS. Our committee never fears losing jurisdiction to anyone else. There are some concerns about that, yes. And I suspect that that may be part of the reason why the bill doesn't go as far as some of us would like to see it go at this point.

Mr. TOWNS. Congressman Mica.

Mr. MICA. Thank you, Mr. Chairman.

I have a copy of a CRS report from June 4. And just reading something that says here, "real economic savings would be achieved"—this is from a direct government loan program—only if the government serviced and administered the program more efficiently than the private sector; a proposition subject to dispute.

That is the basis for a lot of my criticism, that the government can mess up a two-car funeral and, historically, has accomplished that on many occasions.

Mr. Goodling sat here and said you have no technical computer base, you have no financial structure, you have increased default, less audit capability than the current system, you have no management capability; and history says that the programs that they have already been involved in have been a disaster.

Mr. ANDREWS. Do I really think the government could run the system better than the private sector? No, I do not. But the bill does not call for that. The bill calls for the Department to go to the private sector and go to the most competent bidder.

Mr. MICA. I have not been here long. I serve on another subcommittee. We have been looking at EPA. EPA contracts out a great deal of their operations. And the problems that EPA has with administering their programs that they contract out is the same things that Mr. Goodling just went over here. All those systems just don't work. And when you rely on a government agency to implement them, even to do the contracting—which EPA is a perfect example of—you have a disaster; and EPA is a total disaster.

I would like to be optimistic also, as I started out when I came here 5 months ago; but I cannot see, without these things first being in place—and even if they were in place, I am still a skeptic.

Mr. ANDREWS. Here is the economic architecture of this idea. The present system says that the taxpayers you and I represent, pay to banks for in-school interest an interest rate that is 310 basis points higher than the Treasury bill rate, 3.1 percent. If the administrative system that is contemplated by direct lending would cost less than 310 basis points, this idea will save money. By definition.

It doesn't matter if the interest rate is 15 percent or whether it is 4 percent or 6 percent because it floats.

To use your EPA example. It would be as if the EPA knew that there was a set of engineering companies that could do a service in cleaning up superfund sites for 30 percent less than the ones they are presently using, but they still chose to go to the ones cleaning up the superfund sites for the 30 percent.

I understand the argument that we shouldn't turn something done well in the private sector over to the government. That is at the first level of rhetoric in this debate. That is what people hear, and they are attracted to oppose this idea.

That is not what this idea does. This is nothing more than a public subsidy for an industry to do something in terms of a capital acquisition that we could do cheaper and better. That is all this is.

And if the proposal said we are going to set up a huge bureaucracy in the Department of Education to set up and service loans, that criticism would be valid. But because the bill does not call for that, I think the facts are different than those which underlie the question.

Mr. MICA. I hope your proposal and history show me wrong.

Mr. TOWNS. Thank you very much.

We have been joined by Congressman Payne, who has been involved in this issue over the years.

Congressman Payne from New Jersey.

Mr. PAYNE. Thank you very much, Mr. Chairman.

I see my colleague from New Jersey. And, Mr. Andrews, I would like to commend you for the effort you have put into this direct loan program.

I also see our colleague here, Mr. Petri, who has worked hard in the Education and Labor Committee.

I understand that it is a 5-year phase in program. And I wonder if you could explain how it is phased in over the 5-year period.

Mr. ANDREWS. The administration's bill calls for a phase-in by percentage of schools participating. In the first year, it is 4 percent of the schools in the country. In the second year, I believe the number is 29 percent. And it escalates up toward 100 percent in 5 years.

Mr. PAYNE. Is it the largest schools or smaller schools or a combination?

Mr. ANDREWS. The Secretary is directed to create a mix of the phase-in to get a broader picture of how the different sizes of schools would handle the idea.

Mr. PAYNE. Have there been demonstration programs to date? I understand there was a demonstration program a few years ago.

And if so, what were the results of that?

Mr. ANDREWS. There was a demonstration program authorized in the 1992 reauthorization. And as you well know, having been a supporter of it, the demonstration program has never gotten underway because it was scheduled to get underway July 1, 1993. So there has never been a demonstration program of this idea.

Having said that, let me make the point that the Perkins loan program calls for schools to do much more than they will do under direct lending because schools do collection under Perkins. They would not under direct lending.

Second is that many people believe that the paperwork involved in processing a Pell grant for a school is virtually the same as the paperwork identified with processing a direct student loan. It is not quite accurate to say that processing a Pell grant is the same thing as processing a direct student loan, but it is very, very similar.

Mr. PAYNE. Just a final question: As you know, the GAO had indicated, I think in a report, that in their opinion the Department does not have the capacity or personnel with the skills to handle the accounting, the financing, the information systems.

Also, additional personnel would be needed and people with specific skills will be required. Have we examined whether the projected savings would be offset by additional spending in these other areas?

If in fact there are overruns and the need to increase spending in the Department arises, would that mitigate against the amount of loan dollars available for students?

Mr. ANDREWS. Mr. Payne, I share that concern. And the best answer that I can give you is this: The most optimistic assessment of direct loan savings was $6.5 billion. The number that is plugged in the bill is, I believe, $4.57 billion.

The idea being we would take a lower estimate of the savings so as to avoid the problem about which you speak.

Mr. PAYNE. I think that we ought to move ahead and attempt to streamline systems. Anything that saves money that would then go to the student, I think is commendable. So I really support the concept.

I do know that some of the small schools are concerned. It is almost like the founding of the constitution where the large States wanted one sort of a system and the smaller States wanted a Senate-type system. The large States want to go by population. I use that analogy because we see the same thing in a lot of instances;

the smaller schools being concerned about their ability to operate within the parameters of this system.

Mr. ANDREWS. Yes.

Mr. PAYNE. But I think that if the rate of change internally in an agency or institution is not the same as that of the general community, then that operation becomes obsolete.

Mr. ANDREWS. I have also heard, as I think Tom has, from small institutions that we are involved with and represent. And in an attempt to address their valid concerns, the administration's bill does not require any institution to originate direct loans.

If an institution chooses not to take that obligation, students at that school would still get direct loans. Those loans would be originated through another entity designated by the Department of Education for that area.

The entity might be a guarantee agency. It might be a consortium of colleges or schools that are formed for that purpose. The way the bill is written, no college, career school, university, community college, would be required to originate direct loans if it chose not to. And schools that were deemed to be inadequately prepared to do so by the Department would not be permitted to. Their students would be directed to the alternative entities.

Mr. PAYNE. That is an important point. It was suggested that perhaps one of the larger schools in Illinois could handle all of the schools from smaller institutions where the feeling was that they couldn't handle direct lending.

The other problem also, though, is that some of the schools are still in the dark ages regarding their computer systems. And many even have little 5 by 7 cards in a little box. That is inefficient and they should get into the 21st century.

But there is a question and a concern from some of the less endowed institutions and some State-run schools that the costs for upgrading their technology at the school or bringing on more capable people to administer this program will not be offset, nor would there be any funds available from the Department of Education or from some other public entity, State or Federal, to offset the additional costs that they are going to incur by trying to upgrade their systems.

The upgrading is great, and everybody should be proficient and really in the 21st century. But the fact is that they are not, and they are wondering where this additional money will come from.

Mr. ANDREWS. I think the best way to respond is that the program is analagous to the present transaction that schools operate under with the Pell grants. It isn't as complicated as one would originally think.

Second, this is being phased in. So the vast majority of schools would have a 2, 3, or 4-year period to contemplate exactly how they want to handle this.

Third, it won't be imposed upon anyone. A school which chooses not to upgrade capacity and originate student loans, will have their students directed to another originating entity.

And the bill expressly provides for the allocation of administrative costs to cover the costs of the program.

Mr. TOWNS. Thank you very much.

And let me thank you for the time and energy that you have put into this issue; and Congressman Petri, for your time and effort as well. I thought your testimony was outstanding. We look forward to working with you further.

Mr. ANDREWS. We appreciate the opportunity. Thank you.

Mr. TOWNS. Our next witness is Clarence Crawford, the Associate Director for Education and Employment Issues, U.S. General Accounting Office.

Mr. Crawford, I am going to ask you to swear and affirm an oath.

Would you raise your right hand.

[Witness sworn.]

Mr. TOWNS. Let the record reflect that the witness answered in the affirmative.

Mr. Crawford, let me begin by saying it is a pleasure to have you testify before the subcommittee. Your prepared statement will be included in the record, you have 5 minutes to summarize your testimony.

Before you do so, we would like for you to introduce your associates.

STATEMENT OF CLARENCE C. CRAWFORD, ASSOCIATE DIRECTOR, EDUCATION AND EMPLOYMENT ISSUES, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY GLORIA JARMON, ASSISTANT DIRECTOR, ACCOUNT AND FINANCIAL MANAGEMENT DIVISION, AND WAYNE UPSHAW, ASSISTANT DIRECTOR, HUMAN RESOURCES DIVISION

Mr. CRAWFORD. I am happy to do so, Mr. Chairman. I am accompanied by, on my right, Gloria Jarmon and on my left, Wayne Upshaw.

Mr. Chairman and members of the subcommittee. We are pleased——

Mr. TOWNS. Pardon me.

Mr. SCHIFF. I assume both are from the same agency.

Mr. CRAWFORD. From the General Accounting Office. They are involved in the financial aspects of the student loan program.

Mr. TOWNS. You may proceed.

Let me just say to the members, I have tried not to use the 5-minute rule, but I think that we will have to start using it.

We will start it with you, Mr. Crawford.

Mr. CRAWFORD. That is fine, Mr. Chairman.

Mr. Chairman, members of the subcommittee, we are pleased to be here today to discuss the Department of Education's implementation of the Federal direct student lending program. I will just summarize my statement, and in doing so, I will focus on the Department's experience in operating the current guaranteed loan program and lessons learned for the implementation of a direct lending program. We are aware of the administration's proposal to set aside, in effect, the direct lending demonstration in favor of phased in, full implementation.

While the guaranteed loan program has been very successful in providing access to postsecondary education for millions of Americans, the access has come at a cost with well documented abuses. As a result of these abuses, the Comptroller General has des-

ignated the guaranteed student loan program as a high-risk program, and much of our testimony today will be based on our high-risk report and other reports that we have issued.

As was mentioned by the other witnesses, the guaranteed program is complex. In part due to the complexity, the program has a number of problems, and the first problem is in the area of its structure. The program lacks adequate performance incentives for participating lenders, guaranty agencies, and schools. And the behavior of all participants, including students, is not always in the best interests of the American taxpayer; and finally, the Department lacks the resources and the enforcement tools to properly monitor and oversee the program.

As was mentioned by the other witnesses, gatekeeping is another area of concern where the Department's procedures governing the schools that can participate in the program, have been weak. As a result, the Department has not been very effective in weeding out some of the abusive schools.

In the financial management and information systems arena, the Department's systems are not adequate to provide the necessary information to manage and oversee the program.

Because of the above kinds of problems we identified, continued attention on the part of Congress and the administration will be necessary, whether or not they choose to go with a direct lending program phasein or continue the pilot. It is important to note, however, that Congress, the Department, and the Office of Management and Budget have recognized these problems and have attempted to correct staffing inadequacies, controls over schools, and oversight of lenders and guaranty agencies.

In our December 1992 high-risk report, we recognized that a direct lending demonstration was on its way to becoming reality. We suggested that the Department proceed cautiously with a direct lending demonstration program to ensure its proper implementation and subsequent evaluation. We wish to reaffirm that message today.

You also asked us Mr. Chairman, to talk a little bit about some of the key areas that the Department should focus on in implementing a direct lending program. As discussed in my written statement and mentioned by many of the other witnesses, poor management of the program could be a problem, and the Department needs to understand the risks and manage them as it implements direct lending. It needs to make sure that its management and oversight is adequate. In the human resources arena, it needs to make sure that it has the right number and kinds of people on board. It needs to make sure that the contracts for loan servicing and support are adequate to meet the program's needs, and that eligible students have full and complete access to the program. And it needs to also manage the winddown of the guaranteed student loan program.

In summary, the Department has many challenges. It must be prepared to work out the kinks, to minimize the risks. It must—if limitations on access or increases in loan defaults occur—identify and address these issues early.

Mr. Chairman, this concludes my summary. My colleagues and I would be happy to answer any questions that you or other members of the subcommittee may have. Thank you.

[The prepared statement of Mr. Crawford follows:]

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Human Resources and
Intergovernmental Relations,
Committee on Government Operations,
House of Representatives

For Release on Delivery
Expected at
10:00 a.m., EDT
Thursday, June 10, 1993

DIRECT STUDENT LOANS

The Department of Education's Implementation of Direct Lending

Statement of Clarence C. Crawford
Associate Director
Education and Employment Issues
Human Resources Division

GAO/T-HRD-93-26

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the Department of Education's implementation of the Federal Direct Student Loan Program. You asked that we focus on the Department's experiences operating the current guaranteed student loan program--the Federal Family Education Loan Program--and the lessons learned from these experiences as the Department begins to implement and transition to direct lending.

As you know, we began reviewing the direct lending issue about 2 years ago as the Congress was preparing to reauthorize the Higher Education Act of 1965, as amended. In November 1992, we reported that significant cost savings could accrue to the government by making loans directly to students and replacing the guaranteed student loan program--whereby private lenders make loans that the federal government ultimately guarantees against default.[1] These savings were mostly attributed to changes in the government's income from the net interest margin--the difference between the interest rate charged to borrowers and the government's cost of borrowing--and the elimination of interest subsidy payments to lenders. Besides such cost savings, direct lending would require a less complex loan delivery system, benefiting the government through more efficient and cost-effective loan servicing and providing a simpler system for students and schools. But some of the schools' student aid administrators and business officers with whom we spoke shared with us their concerns about the Department's ability to manage a direct lending program. Poor management of a direct lending program by the Department of Education could inhibit access to loans by eligible borrowers and trigger more loan defaults, which could substantially erode any potential cost savings.

In our report, we cautioned that if the views of student aid administrators and business officers are indicative of the views of others, realizing the potential savings from direct lending will require substantial effort on the part of both the schools and the federal government. We suggested that for direct lending to succeed, the Department of Education will need to (1) work with the postsecondary education community and (2) provide strong program leadership as it prepares to implement direct lending.

The Higher Education Amendments of 1992 authorized a direct loan demonstration program to operate concurrently with the guaranteed student loan program. The demonstration is to operate with loans

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[1]Student Loans: Direct Loans Could Save Billions in First 5 Years with Proper Implementation (GAO/HRD-93-27, Nov. 25, 1992).

made from July 1, 1994, through June 30, 1998. The Department is selecting about 250 schools to operate with direct loans and a like number of schools to serve as a control group by continuing with guaranteed loans. We will evaluate the demonstration, reporting to the Congress before January 1, 1997, on our interim results and issuing a final report before May 1, 1998. The remaining schools would continue participating in the guaranteed program, generally unaffected by the demonstration.

Also, the administration is proposing that the Student Loan Reform Act of 1993, through H.R. 2264 (which passed the House on May 27, 1993) and S. 920, would replace the direct loan demonstration and authorize the implementation of direct lending with a phased-in program beginning in July 1994. Beginning in school year 1998, all new student loans would be direct loans. The Department would continue to operate a guaranteed loan program, servicing loans and collecting funds from the outstanding loan portfolio.

STUDENT LOANS--A HIGH-RISK PROGRAM

The current guaranteed student loan program has been the subject of great scrutiny during the last few years primarily because of the rising costs related to defaulted loans. We, as well as the Department's Office of the Inspector General, the Office of Management and Budget, congressional committees, and others, have reported numerous inefficiencies in the Department's management and administration of the program.

The guaranteed loan program has provided billions of dollars of financial aid to postsecondary students since its inception in 1965. It has been very successful in providing access to a postsecondary education for millions of students. But with this access came a variety of abuses reported in the media, including ineligible students receiving loans, schools (mostly for-profit trade schools) focused more on making money than on providing their students an education, and lenders making loans to fictitious students and fraudulently collecting federal funds for defaulted loans that were not properly made or serviced. These kinds of abuses have occurred, in part, because the Department of Education has had difficulty appropriately balancing borrowers' easy access to loans with proper controls to protect the federal government's financial interest.

As you know, the Comptroller General has designated guaranteed student loans a high-risk program.[2] We reported on the

[2]Programs were selected as high risk because they had weaknesses in internal controls or in financial management systems, and correcting these problems is essential to safeguarding scarce government resources and ensuring their efficient and effective use.

vulnerabilities in the loan program in December 1992 in one of our 17 high-risk reports.[3] We discussed many of the problems, their principal causes, and our suggestions for improving the guaranteed loan program. Our high-risk report and others we issued during the last few years form the basis for our statement today. (See attachment for list of related products.)

STUDENT LOANS--A HISTORY OF PROBLEMS

The loan program has been besieged with a variety of problems, the causes of which are many and the fixes for which are far from simple. The program is complex, which contributes to its vulnerability to abuse. For example, there are over 7,500 schools, 7,800 lenders, and 46 guaranty agencies sharing responsibility for annually making about 4 million loans--averaging less than $2,900 each--to millions of borrowers. The Department makes interest subsidy payments and pays claims for defaulted loans without adequate documentation, relying on billings submitted by lenders and guaranty agencies. In addition, the program has an inherent risk built into it: most loans are made to borrowers who have little or no credit history. This, not surprisingly, contributes significantly to high default rates.

The Congress and others recognize that there is an inherent risk in a program of this nature. But there are also known vulnerabilities in how the program is being managed that can and should be addressed. We have reported on these kinds of vulnerabilities several times,[4] and they include:

Program Structure

Within the current structure, the Department has struggled to manage the numerous participants as it made $15 billion in new loans in fiscal year 1992, and guaranteed a loan portfolio totaling $63 billion as of September 30, 1992. The behavior of all participants--schools, students, lenders, and guaranty agencies--has not been in the best interest of the American taxpayer. This has led to abuses, such as lenders making loans to fictitious borrowers, guaranty agencies not adequately reviewing and paying defaulted loan claims or maintaining accurate loan data on borrowers, schools misrepresenting their academic capabilities, and

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[3]High-Risk Series: Guaranteed Student Loans (GAO/HR-93-2, Dec. 1992).

[4]Including High-Risk Series: Guaranteed Student Loans (GAO/HR-93-2, Dec. 1992); Financial Audit: Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement (GAO/AFMD-93-20, Mar. 16, 1993); and Stafford Student Loans: Millions of Dollars in Loans Awarded to Ineligible Borrowers (GAO/IMTEC-91-7, Dec. 12, 1990).

students falsifying their loan applications. In addition, the Department lacks the resources and enforcement tools to appropriately monitor and oversee this large group of participants.

The program lacks adequate performance incentives for lenders, guaranty agencies, and schools participating in the program. For example, we reported that lenders and guaranty agencies are paid for defaulted loans if certain servicing steps (called due diligence) are taken. But guaranty agencies generally pay lenders 100 percent of loans that default, and the agencies generally receive 100 percent from the Department if they are unsuccessful in keeping a loan from defaulting. After the Department pays default claims, the guaranty agencies retain the loan and continue trying to collect it, retaining 30 percent of amounts that they may subsequentially collect. According to Department data, during fiscal year 1991, about 13 percent, or more than $200 million, of guaranty agency revenues were from collections on defaulted loans. Therefore, the agencies have more incentives to collect on loans after they are defaulted than to work with borrowers and lenders to prevent loans from becoming defaulted because (1) agencies can earn additional revenue from default collections but not from performing due diligence procedures and (2) default-prevention incentives have not been as effective as intended.

Gatekeeping Procedures

The Department's gatekeeping procedures for determining which schools can participate--and continue to participate--in the program have been weak. The Department's oversight has been minimal, and it must rely on others--accrediting organizations and state licensing agencies--to ensure the quality of education that schools provide. Such slack oversight practices have not been successful in weeding out schools that exhibit abusive behavior, such as collecting tuition payments for marginal instruction. For example, the lure of plentiful financial aid for proprietary school students, and abusive practices of some proprietary schools--including fraud--has had a disproportionate impact on defaults. In 1990, students attending these schools represented 41 percent of borrowers, but 77 percent of those who had defaulted loans.

Financial and Management Systems

The Department's financial and management systems are not adequate to provide the information necessary to manage and oversee the program and protect the federal interest. To illustrate:

-- Management information systems contain data that are not always accurate and timely, limiting the systems' use for compliance and evaluation purposes. For example, in a sample of loan data reported to the Department by guaranty agencies, 2 of 10 agencies that we reviewed did not send in their loan data within 60 days of the end of fiscal year 1991. This late

reporting resulted in these agencies receiving a higher than appropriate reimbursement for defaults. Both of the agencies we reviewed that submitted reports after the year-end cut-off date would have been reimbursed by the Department at a lower rate if they had reported on time.

-- A complete and accurate student loan data system was lacking, which contributed to loans being made to borrowers in default or otherwise ineligible for loans. This condition exists, in part, because data submitted by guaranty agencies in many instances are incomplete, inaccurate, and not timely, and the Department has little means to ensure that accurate data are submitted. For example, our analysis of Department data showed that about $42 million of new loans were made to students in fiscal year 1988 who had defaulted on earlier loans. Another $5 million may have been loaned to students during the 12 months ending August 1988 in excess of annual statutory loan limits. In addition to making these loans, the government paid interest subsidies to lenders over the life of the loans.

-- A shortage of qualified staff plagues the management of the guaranteed loan program. The program office has a shortage of adequately trained staff, and some staff members lack the appropriate skills, such as finance, information systems, data analysis, planning, and policy making skills. For example, there are few employees with financial or accounting backgrounds to administer the $15 billion in new loans made annually.

-- Financial audits do not include in-depth examinations of the accuracy and validity of lenders' and guaranty agencies' claims for interest subsidies, defaulted loans, and administrative cost allowances. For example, at times, records supporting the Department's payments to lenders and guaranty agencies have been missing, incomplete, or inaccurate. Also, the Department has relied heavily on an honor system in its financial management activities. It pays over $5 billion annually to lenders and guaranty agencies based on unaudited summary billings.

American taxpayers, therefore, have been underwriting a program that lacks the oversight and internal controls needed to properly safeguard its substantial investment. The Department of Education, schools, lenders, and guaranty agencies should do more to control the program's risks.

FIXING KNOWN PROBLEMS IN THE STUDENT LOAN PROGRAM

Many of the problems we identified will require the continued attention of the Congress and the Department of Education whether student loans continue to be provided by private-sector lenders and

guaranteed by the government or made directly by the government. The Congress, the Department, and the Office of Management and Budget have recognized these kinds of problems and attempted to correct many of them. For example, the Department has worked to correct staffing inadequacies, controls over schools, and oversight of lenders and guaranty agencies. Nevertheless, the urgency of resolving these kinds of problems is important because under either the existing legislation in which the Department will operate the direct lending demonstration program or the phased-in program as specified in H.R. 2264, the Department of Education will be operating two student loan programs concurrently. Whether private lenders or the government originate student loans makes fixing the Department's underlying data collection and supporting systems as soon as possible imperative.

What can be done to address the Department's management efficiencies? One principal issue that deserves attention is the structure of the guaranteed student loan program. There are more participants--lenders and guaranty agencies--than are needed to effectively operate the program. With the automation and electronic transfer capabilities in existence today, providing borrowers access to loans can be ensured with fewer participants. A program with fewer participants would also make the Department's oversight and monitoring responsibilities more manageable, as well as streamlining the loan delivery system for both schools and students.

We want to discuss several other issues that we believe should be addressed, whether the current system is retained or direct lending is implemented in some fashion.

-- The need to continue strengthening the Department's gatekeeping procedures to more effectively determine the fiscal and administrative capabilities of schools seeking to participate in student aid programs, as well as those wanting to continue. Part of this effort should include the use of outcome measures, such as school completion rates and job placement rates.

-- Strengthening the incentives for effective loan servicing and default prevention by lenders, guaranty agencies, and servicers, partly by establishing results-oriented default prevention incentives, and partly by comparing the needs and benefits of the current number of guaranty agencies with the benefits of consolidating the guaranty agencies.

-- Expediting efforts to develop a comprehensive plan to identify and correct longstanding problems in the Department's financial and information management systems for its student loan programs.

In our high-risk report, we recognized that direct lending (we were referring to the demonstration program) was on the way to becoming

a reality. We suggested that the Department proceed cautiously with the direct lending demonstration program to ensure its proper implementation and subsequent evaluation. We wish to reaffirm that message today, whether the Department phases in full implementation or operates the demonstration program as authorized by the 1992 amendments.

IMPLEMENTING DIRECT LENDING

You also asked that we comment on the key areas that the Department should focus on as it prepares to implement direct lending. As we discussed earlier, poor management by the Department of Education could increase the risk of failure as direct lending is implemented. The primary loser in such a scenario would be students and schools if access was somehow compromised, and the federal government and taxpayers if defaults were to increase. To minimize these risks, the Department needs to keenly focus on properly implementing direct lending. While we have not performed an in-depth review of this subject, we believe a comprehensive strategy is needed for the direct loan conversion effort. This strategy should address the management and oversight of the conversion, human resources and support requirements, loan servicing and support to schools and students, and management and the winding down of the guaranteed loan portfolio. Along these lines some of our specific observations, on the basis of our past work, include:

-- Management and Oversight Ensure that the Department's management structure is adequately overseeing the design and implementation of direct lending and the winding down of the current guaranteed loan system. Among its responsibilities are the development of specific project and acquisition plans and timelines and the early identification and prompt management of risks, along with the development of the information and financial management systems to support direct lending, which includes interaction with the existing guaranteed student loan systems.

-- Human Resources and Support In determining and obtaining the resources needed to implement direct lending, the Department should ensure that it is identifying adequate technically qualified staff, contract support, equipment, and space. For example, it must address how it will manage the staffing needed for the development and implementation period, as well as articulate how it will handle winding down the guaranteed loan program.

-- Loan Servicing and Support to Schools and Students Assuring access to student financial assistance must continue to be a principal objective. The Department must continue to develop and execute contracts that will encourage the efficient servicing of loans and provide proper incentives for default

prevention. It must issue necessary rules and regulations in a timely manner, develop a strategy for providing training and other assistance to schools as they assume new responsibilities under direct loans, and provide "on demand" assistance to students and school financial aid administrators and business officers.

-- Guaranteed Loan Program Wind Down Develop a strategy for the orderly management and winding down of the current $63 billion loan portfolio. The Department should explore alternative strategies for winding down the current program and provide back-up systems as lenders and guaranty agencies wind down or stop participating in the guaranteed loan program.

In summary, implementing direct lending will be a challenge to the Department of Education. It must be prepared to promptly work out kinks in the program to minimize the risks. If limitations on access or increases in loan defaults occur, the Department must identify and address them early to ensure the integrity of direct lending as the principal federal provider of financial aid to postsecondary students.

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Mr. Chairman, that concludes my statement. My colleagues and I would be happy to answer any question that you or the other Committee members may have.

Attachment

ATTACHMENT ATTACHMENT

RELATED GAO PRODUCTS

Department of Education: Long-Standing Management Problems Hamper Reform (GAO/HRD-93-47, May 28, 1993).

Financial Audit: Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement (GAO/AFMD-93-20, Mar. 16, 1993).

High-Risk Series: Guaranteed Student Loans (GAO/HR-93-2, Dec. 1992).

Transition Series: Education Issues (GAO/OCG-93-18TR, Dec. 1992).

Student Loans: Direct Loans Could Save Billions in First 5 Years With Proper Implementation (GAO/HRD-93-27, Nov. 25, 1992).

Guaranty Agency Solvency: Can the Government Recover HEAF's First-Year Liquidation Cost of $212 Million? (GAO/HRD-93-12BR, Nov. 13, 1992).

Guaranteed Student Loans: Prompt Payment of Origination Fees Could Reduce Costs (GAO/HRD-92-61, July 24, 1992).

Guaranteed Student Loans: Eliminating Interest Rate Floors Could Generate Substantial Savings (GAO/HRD-92-113, July 21, 1992).

Student Financial Aid: Education Can Do More to Screen Schools Before Students Receive Aid (GAO/HRD-91-145, Sept. 27, 1991).

Student Loans: Direct Loans Could Save Money and Simplify Program Administration (GAO/HRD-91-144BR, Sept. 27, 1991).

Student Loans: Characteristics of Defaulted Borrowers in the Stafford Student Loan Program (GAO/HRD-91-82BR, Apr. 26, 1991).

Stafford Student Loans: Millions of Dollars Awarded to Ineligible Borrowers (GAO/IMTEC-91-7, Dec. 12, 1990).

Defaulted Student Loans: Analysis of Defaulted Borrowers at Schools Accredited by Seven Agencies (GAO/HRD-90-178FS, Sept. 12, 1990).

Mr. TOWNS. Thank you very much. And let me say to my colleagues that we are applying the 5-minute rule. However, if you would need a second round, then we will agree to do so. But let's try to adhere to the 5-minute rule as we move along.

Let me thank you very much, Mr. Crawford for your testimony.

Earlier Congressman Andrews testified that the GAO and the administration estimate that a direct lending program could save the Federal Government over $4 billion. I have a letter to this subcommittee dated May 26, 1993, from the Congressional Budget Office which reported that the real savings on direct lending would be around $2 billion.

Mr. TOWNS. Have you seen the CBO letter?

Mr. CRAWFORD. Yes, sir, Mr. Chairman. We have.

Mr. TOWNS. How do you reconcile the differences between your cost savings and the CBO cost savings?

Mr. CRAWFORD. When we prepared our cost savings estimate last year, we were assuming, for the purpose of the exercise, a full 5 years of implementation of direct lending. We did not consider a phasein. That is one aspect of it.

Second, there is a difference in the interest rate assumptions that we used last year, based on the CBO estimates. CBO adjusted its rates downward since we issued our report, and if we revised our rates downwardly to be consistent with the current numbers, CBO and GAO estimates are much closer.

In short, when you take into account—and also the treatment of administrative costs under credit reform, certain administrative costs are not present valued. When we did our model, we tried to look at the full cost of direct lending.

When all of these differences are taken into account, and if we were to essentially do a similar-type analysis as CBO, we would tend to agree that a phasein would result in a lower cost savings.

Mr. TOWNS. So it is safe to say that both the GAO and CBO are in general agreement about the cost savings?

Mr. CRAWFORD. That is correct.

Mr. TOWNS. Without objection I would like to place the CBO letter of May 26, 1993, into the record.

[The information follows:]

CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, D.C. 20515

Robert D. Reischauer
Director

May 26, 1993

Honorable Edolphus Towns
Chairman
Subcommittee on Human Resources
and Intergovernmental Relations
Committee on Government Operations
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Based on your May 14th request, the Congressional Budget Office has prepared the enclosed cost comparison of the reconciliation recommendations of the Committee on Education and Labor relating to direct student loans. You requested that CBO provide estimates of the direct loan proposal using the estimating rules stated in the Credit Reform Act of 1990 that requires federal administrative expenses to be estimated on a cash basis and under an alternative technique in which all federal administrative expenses associated with each year's loans are estimated on a net present value basis.

Under the proposed direct loan program, administrative expenses will increase when students begin either to repay loans or to default on loans. When administrative expenses are estimated on a cash basis, these higher administrative expenses are not included in the estimate because they will generally occur after 1998. For this reason, when administrative costs are estimated on a net present value basis, the estimated costs of a direct student loan program increase and the resulting savings from converting the current guaranteed loan programs to direct loan programs fall.

As shown in the enclosed table, we estimate that the five-year savings of $4.27 billion from the Education and Labor Committee's proposal to convert current guaranteed loan programs to direct loans fall to $2.08 billion when federal administrative expenses are estimated on a net present value basis.

If you wish further details on these estimates, we will be pleased to provide them. The CBO staff contact is Deborah Kalcevic, who can be reached at 226-2820.

Sincerely,

Robert D. Reischauer
Director

Enclosure

cc: Honorable William D. Ford
Chairman
Committee on Education and Labor

Honorable William F. Goodling
Ranking Minority Member
Committee on Education and Labor

COMPARISON OF COST ESTIMATES
OF
THE HOUSE EDUCATION AND LABOR COMMITTEE
Reconciliation Recommendation for Direct Student Loans
Under a Proposed Subsidy-Basis Scoring Rule for Administrative Costs
Compared to the Current Cash-Basis Scoring Rule for Administrative Costs

(by fiscal years, in millions of dollars)

	1994	1995	1996	1997	1998	1994-1998 Total
Direct Student Loans With Administrative Costs Under Proposed Subsidy-Basis Scoring[a]						
Estimated Budget Authority	85	5	-405	-945	-1,110	-2,370
Estimated Outlays	130	40	-260	-855	-1,135	-2,080
Direct Student Loans With Administrative Costs Under Current Cash-Basis Scoring						
Estimated Budget Authority	65	-180	-930	-1,895	-2,135	-5,075
Estimated Outlays	115	-85	-650	-1,610	-2,040	-4,270
DIFFERENCE:						
Estimated Budget Authority	20	185	525	950	1,025	2,705
Estimated Outlays	15	125	390	755	905	2,190

a. Under credit reform, all the costs of federal loan programs--with the exception of federal administrative costs--are estimated on a subsidy basis. Subsidy costs are the estimated long-term cost to the government on a net present value basis associated with all the loans disbursed in any particular fiscal year. It is these costs which are used for budget scoring. However, under credit reform, federal administrative costs are estimated on a cash-basis. Annual administrative costs are measured in terms of net-cash expenditures from Treasury in the year they are made and are associated with all loans outstanding during that year. These cash costs are used for budget scoring.

Under current budget scoring rules for the current guaranteed student loan program, the costs associated with loan servicing and default collections are included in the subsidy cost calculation as one of the components of the lender's total yield. However, these same expenditures for the direct student loan program are included in the estimated costs on an annual cash basis. The proposed subsidy-basis scoring would include these loan servicing and default collection costs on the same subsidy basis as those associated with the guaranteed loan programs.

CBO Analyst: Deborah Kalcevich
(226-2820)
May 26, 1993

Mr. TOWNS. My understanding of your testimony and your previous reports on the student loan program is that it has been badly mismanaged; is that correct?

Mr. CRAWFORD. There have been many problems, well documented in the news media, and in other places as well, including the inspector general, the Office of Management and Budget, and various committees here on the Hill. Correct.

Mr. TOWNS. It is also true that over the past several years the political leadership at the Department has virtually ignored the management needs of the student loan program?

Mr. CRAWFORD. I think that there have been management problems at the Department. I don't think I am in a position to comment on what their thinking is. I can tell you that within the last couple of years, the Department has been trying, and working pretty hard in fixing things.

Mr. TOWNS. Let me put it this way: If these problems are not corrected, what impact would they have on the effectiveness of a direct lending proposal?

Mr. CRAWFORD. I think you have to recognize that the problems that we and others have reported are large problems, and they don't always lend themselves to very quick solutions.

When you move into the direct lending arena, in effect the Department will be operating two programs, two relatively large programs. It will have the guaranteed student loan program that will still have to be managed because of a portfolio of loans out there, some $60 billion in loans that could perhaps be in existence for 10, 15, 20 years. At the same time, the Department faces the issue of starting up a new program.

Some of the problems that are occurring now in the guaranteed program would also impact the direct program. For example, in the financial management and the information systems areas, there is still a need to improve these systems as the Department builds the direct lending program. If that is where it is going to head, into some kind of implementation of direct lending, the Department still has to be able to establish the interfaces needed between the direct lending program and its information and data systems, and what needs to be done with the guaranteed program as it is winding that down. Also, some of the problems, such as gatekeeping concerns, in terms of being able to do a better job of weeding out abusive schools, is an issue that the Department must work on.

There are also issues of the qualifications of the staff that still must be addressed. So these kinds of problems don't go away with direct lending and the Department still has to, in many cases, address them. Some of the problems that were identified with the current problem just can't be ignored with direct lending, they cannot be set aside.

Mr. TOWNS. Right, the words phasein and pilot program have been used throughout the morning, which sound good, but I think in order to correct the problems, wouldn't it be necessary for the Department to have a comprehensive master plan defining what the management problems are and how the Department intends to correct these problems before moving forward?

Mr. CRAWFORD. Yes, I think it would be necessary for the Department, embarking upon an effort of this magnitude, to develop

an overall strategy, a plan as to how it is going to, one, develop the direct lending program, two, continue to manage the guaranteed loan program, three, wind down the guaranteed loan program, and four, completely make the transition at some point in time to a direct lending program.

Mr. TOWNS. Well, I see the red light is on. Let me just ask one more question. In your opinion, if the Department does not have a master plan, what would your assessment be of its ability to manage a direct lending program?

Mr. CRAWFORD. I think it needs a master plan to help it manage the program. That is one way that it can manage the risk, to know what are the risks. To move into the direct lending program without having a master plan, or having plans to develop one in a relatively short period of time, would not be a very good sign.

Mr. TOWNS. Thank you very much.

Congressman Schiff.

Mr. SCHIFF. Thank you, Mr. Chairman. I will be brief.

To follow up, Mr. Crawford, on the chairman's asking you to compare GAO's view with the Congressional Budget Office, let me complicate the matter a little further here and ask if you are familiar with the Congressional Research Service report on this issue. I am looking for—I believe it is dated—June 4, 1993, is the date I have on it.

Mr. CRAWFORD. Yes, sir, I have seen that.

Mr. SCHIFF. If I am reading them correctly, they are—they are rather skeptical of how much savings and how you credit it. Is that how you read it?

Mr. CRAWFORD. The CBO—rather the CRS, has some different assumptions, and we can talk about that. In fact, Mr. Upshaw can give you highlights of the assumptions.

Mr. UPSHAW. I think one of the principal reasons that CRS states a lot of skepticism about the projected savings that we at GAO have conducted, centers around their calculation of the prepayment risk. While the prepayment risk is material, the likelihood of it being a real showstopper or having a real material effect in terms of eroding the cost is greatly mitigated by one, the Higher Education Amendments of 1992 linking the interest rate to market rates, and two, the motivations for students to seek alternative financing to lower their interest rates. Prepayment risks are greatly reduced, and from a practical standpoint, pretty much eliminated.

Mr. SCHIFF. I thank you, Mr. Upshaw, for the answer.

Before I yield back, I want to make two observations. This whole matter seems to me to be based upon the assumptions that are being made, whether its for the Congress or our agencies.

The general theory goes like this: If we do it ourselves, we will save the cost of the middleman, in this case the banks, and the savings will be passed on to the students. I think it is a wonderful theory, but you have to make certain assumptions that it will all work that way in practice. And, you know, I am not sure we can make all those assumptions.

I would further observe that some of the things I think we need, such as getting the Internal Revenue Service perhaps further involved in the collection of defaulted student loans, which has been

referred to here, I think could be done today, without making any other changes in the system.

Nevertheless, I again appreciate the testimony of this panel and the information that they have provided.

I yield back to you, Mr. Chairman.

Mr. TOWNS. Thank you very much.

Congressman Sanders.

Mr. SANDERS. No questions at this time.

Mr. TOWNS. Congressman Payne.

Mr. PAYNE. Thank you, Mr. Chairman. Is that time off of my 5 minutes? We are going to have to run—but let me mention one thing, it seem to me, since we have the GAO report, the CBO report, and the Library of Congress, the Congressional Research-CRS report, it would appear that everyone is operating under a lot of assumptions, and everything has been indicated as being an assumption; and some people have a saying about assuming things.

You know, of course, this is a congressional hearing, but it would appear to me that if these three agencies could somehow come together in a friendly, positive atmosphere to debate or to reconcile the various assumptions and how each has come up with—I think we want to see something that is going to work, and save several billion dollars, that means we have more resources for students who are in dire need of them, then we support it.

It would appear to me, though, when you have agencies, all of which are competent and respected—come up with three different views, that if necessary we would benefit by having those agencies get together and have dialog about these different perspectives and come up with some consensus report. I think this issue is too big to go forward with such different assumptions and projected outcomes.

And so I am sure that is not necessarily in your jurisdiction, but maybe to you, Mr. Chairman, it might be a suggestion. I don't know if Federal agencies can talk to one another. You know, I don't want to start something—I don't want to disrupt the government flow. But it might be a suggestion that somehow——

Mr. TOWNS. Maybe we can make an exception.

Mr. PAYNE. That is right. So that statement—my concern is about the differences of views, and whether in some way, there could be a reconciliation of those points of view. I would feel more comfortable.

Thank you.

Mr. TOWNS. Thank you.

Mr. Mica.

Mr. MICA. Thank you, Mr. Chairman. The only question I had, too, is from the CRS report.

One of the things that they had said in the report is that the budget savings shift from direct lending are equally achievable by adjusting lender returns in the current program. Was that looked at as an option, adjusting lender returns in the current program; or were you just looking at the direct loan-lending avenue?

Mr. CRAWFORD. We have looked at—in the past, we had made recommendations to adjust subsidies paid to lenders. I think also that when we looked at direct lending and issued our report, we

were looking—in addition to just the cost savings—we were also looking at, in some ways, a more simplified system.

The current guaranteed loan program system now has about 7,800 lenders, 47 guaranty agencies, and a number of secondary markets. We were beginning to wonder—looking at our experience with the problems that the Department was having—whether in addition to improved management, some kind of structural fix was necessary. In today's environment, with electronic fund transfers and other improvements in information, technology, and financial management, we question whether there is really a need at present to have a system with such a large number of participants.

So that was part of our motivation. Assuming that even if we did improve the Department's management, it probably was a very large system to manage.

Mr. MICA. Thank you.

Just finally, Mr. Chairman, the information you got: Was that from the Congressional Budget Office and was that over a 5-year period?

Mr. TOWNS. Yes.

Mr. MICA. So yours is about $400 million per year and yours was $1 billion 1 year, 5 years, $5 billion?

Mr. CRAWFORD. Ours assumed a full 5 years of operation, not a phasein, we also assumed a higher interest rate at the time. When we use current CBO estimates for interest rates, CBO's scoring for the budget more closely approximates ours.

Mr. MICA. Thank you, Mr. Chairman.

Mr. PAYNE. Mr. Chairman, if the gentleman would yield on that point for a second. If you would merge the assumptions together, from the other reports, then could there be a conciliation of their respective conclusions? Maybe that is what we could do, to see if everybody is on apples, rather than apples and oranges; and to see how close they could come. Is that possible?

Mr. UPSHAW. With regard to CBO's projection, if you calibrate the different conventions, then our bottom lines are approximately the same.

Mr. CRAWFORD. Yes.

Mr. TOWNS. OK. What I would like to do is break for 15 minutes, come back at 12:10 and, maybe we can just finish with this before we leave.

Do you have any other questions? Let me just ask two quick questions.

The Department is currently developing the National Student Loan Data System, which you have projected will not be ready until December of this year at the earliest. What changes would have to be made in the system in order to accommodate the data necessary to implement a direct lending plan?

Mr. CRAWFORD. I would like Gloria Jarmon to respond.

Ms. JARMON. Currently, the first phase of the National Student Loan Data System, from the latest estimate we have heard, would be complete by mid-1994. Currently that system is planned to be more of a data system, to maintain the data needed to determine if students are receiving more loans than they should receive and if defaulted students are receiving new loans they should not be receiving.

It is our understanding that the system has not been designed to include direct loan components. In order to include direct loan components, I am sure there would have to be more financial and accounting plans for the system to be able to be used as an accounting information system. It is our understanding that the data system is to be used as an information system, just to maintain data, in the first phase. There are plans for future phases.

Mr. TOWNS. Let me thank all of you for your testimony. It was very informative. As one of the members here stated, I think we have some serious problems. Thank you, Mr. Crawford, Mr. Upshaw, and Ms. Jarmon; thank you very much.

When we return at 12:10, we will begin with Deputy Secretary Kunin.

[Recess taken.]

Mr. TOWNS. Our next witness is the Deputy Secretary of the Department of Education, Madeleine Kunin. As Deputy Secretary, Ms. Kunin has taken the lead in implementing the "Reinventing Government" initiatives in the Department. She is also the White House and interagency liaison on such issues as national service, education reform, and youth apprenticeship.

Ms. Kunin also served as the Governor of the State of Vermont for three terms, from 1985 to 1991, where she became the first woman ever elected to the position.

Let me at this point say to you that we appreciate the kind of time that you have set aside for us this morning, and we apologize for the delays, We thought we had one vote, but we actually had two, and this took additional time.

In the interest of time, please summarize your statement. Your entire statement will be included in the record. In terms of your time constraints, I am certain that the members will cooperate with you totally, because we know what it's like when you are supposed to be somewhere else at a certain time—we all can relate to that.

[Witnesses sworn.]

Mr. TOWNS. Ms. Kunin.

STATEMENT OF MADELEINE KUNIN, DEPUTY SECRETARY OF EDUCATION, U.S. DEPARTMENT OF EDUCATION, ACCOMPANIED BY MAUREEN McLAUGHLIN, ACTING ASSISTANT SECRETARY, OFFICE OF POSTSECONDARY EDUCATION, AND THOMAS P. SKELLY, DIRECTOR OF BUDGET SYSTEMS

Ms. KUNIN. Thank you very much, Mr. Chairman and members of the subcommittee. And let me say, first off, that we very much appreciate this chance for the new Department of Education, under new management, to testify before the subcommittee and respond also to some of the testimony that you have just heard. As you indicated, I am happy to make my formal testimony part of the overall record.

Of course, the reason we are here at all is because this is a unique and, frankly, very exciting and important opportunity to change the way government does business to better serve students and their families, to save the taxpayers a considerable amount of money and to provide the kind of access to higher education that we all know is almost a necessity in today's economy.

I think, just as an overall observation of the development of the student loan program, there has always been a tension, if you look back historically, between opening up access and providing everyone a chance to get a loan or a grant who qualifies, so you can have a college education, and simultaneously providing accountability within that system to make sure the system is not abused. And some of the long history, I think, has been a conflict between full accountability and full access.

Our total policy is not to do one at the expense of the other. We want to have full accountability in the student loan program as we move toward direct lending, and we want to maintain the integrity of the student loan system in the sense of providing that access to students, providing a stable system that will not result in glitches that interrupt the flow of capital, that interrupt the reliability of the system. Because we take very, very seriously the great responsibility placed on the Department of Education; the President of the United States takes that responsibility very seriously, and so does Secretary of Education Riley because, you know, there are 5 million students a year who depend on these loans for their education, but the taxpayers also deserve to get the best deal.

When we are doing this, we obviously want to be sure that we don't waste money, that we use it prudently.

Now, there are a couple of questions that came up this morning that I would just like to respond to. One is the assumption that there are a lot of estimates floating around that contradict one another in terms of the savings. The answer is if you use the same rules—and that is the Credit Reform Act of 1991—if you use the same rules, the estimates do not differ. In fact, the Department of Education, the Congressional Budget Office, and OMB worked in the past several months to reach a similar consensus that the overall saving is $4.3 billion over 5 years and that the annual steady stream savings are $2 billion.

The recent CBO letter was a response to a "what if" question—what if you use different rules? If you went back to the old rules, would there be a difference? Yes. But the whole financial system of the government, the way everything is scored has to have certain consistencies, so we are using the rules as they exist, as the law was passed, to score the savings. And I think that is an important point that there is not as much diversity in the estimates as one might assume on initial questioning.

Now, second, as far as the CRS report is concerned, without going into a detailed analysis of that, the CRS report, one, assumes that the present system is competitive. The present system, for all intents and purposes, is not competitive; even though you have private providers of some of the services, they are guaranteed a fixed rate of return regardless of the quality of services that they provide.

I think that is a very, very important point. And it is one that Congressman Andrews made as well. We are not taking a free enterprise system and federalizing it. We are, in fact, improving the entrepreneurial and competitive possibilities by going toward and finally implementing full direct lending, because people are going to have to compete for the business in order to achieve a government contract. They are going to have to compete on the basis of

price and on the basis of quality, and the beneficiary will be the taxpayer.

Right now, the benefits of competition never come to the Federal Government because, regardless of performance, the same rate of return is guaranteed. In fact, there are even some incentives to encourage defaults in the present system when guaranty agencies are given 30 percent of the defaults that they collect.

One might even argue that it is moving the wrong way. The Federal Government, under the present system, has all the risk. The Federal Government has to deal with a system that is so complex that the GAO concluded that—in this report that you have heard further comment on—that the structure of the system dooms it to inefficiency.

The first thing that I did and that the Secretary did was to get briefed on this GAO report, and the first thing we realized was that the present structure would never enable us to run and manage an efficient student loan system and that the only alternative was to move toward direct lending where you have greater simplicity and, therefore, greater accountability. When you have 7,800 lenders, when you have 46 guaranty agencies, when you have other secondary markets, you can imagine the complexity of the system.

Now, there have been legitimate questions raised about the capacity of the Department to manage this system. I think the most forthright answer to give you is that regardless of whether we go to direct lending, we have begun the process and will go full speed ahead to improve the management, not only of direct lending, not only of guaranteed student loans, but the overall Department. And the Secretary has asked me personally to take the responsibility for management, and I've happily assumed that responsibility.

He has also asked, and we have asked every Assistant Secretary to assume management responsibilities because we are determined—and I make this commitment to you for the record—to make the Department of Education a model Department in the Federal Government. And some steps have already been taken. The designated Assistant Secretary for Postsecondary Education, who is about to be fully confirmed, is a person who probably knows more than anybody else in the country about student loans.

We are in the process of getting a top-rate CFO for the Department. We are in the midst of developing a strategic plan. We are developing and have on line management systems and the technology to carry out this program; and I know that time is limited, and probably that means another vote, but I want to convey to you the bottom line that we are aware of the problem. We have started to fix it, and we are determined to fix it and to make this program, as well as the overall Department, work.

We don't say this lightly. We know it will take people. We know it will take a change in the culture. We know it will take the support of the Congress to give us the people and the technology to make it happen. But we are very confident that we can deliver; and we have begun that process, and we are going to continue that process and pay attention every inch of the way in terms of regulations, in terms of deadlines, in terms of commitments.

We are taking some giant steps.

Let me also take this belated opportunity to introduce to you Maureen McLaughlin, who has been the Acting Assistant Secretary of Postsecondary Education, and Tom Skelly from the Budget Department. At either side of me, I have two of the most competent people in the Education Department, but they are not alone. We have some terrific career people in the Education Department, and there is now a great opportunity to use their talents, combined with the new political appointees, and really build a team.

I think that is the way you make government work. You make it responsive. You see the public as a customer, you build a cohesive spirit within, you bring in the best talent from without; and you take your responsibilities seriously, and deliver results.

So we feel very pleased about this opportunity to improve the system. We look forward to reporting to you regularly on progress that has been made. We expect some glitches to occur. We will try to notify you as early as possible about them, but I think the time has come to seize this opportunity to move toward a new system that really serves the people in the way that they deserve to be served and to provide access and accountability when it comes to higher education.

Thank you very much.

[The prepared statement of Ms. Kunin follows:]

U.S. DEPARTMENT OF EDUCATION

Statement by

Deputy Secretary of Education
Madeleine Kunin

before the

Subcommittee on Human Resources and Intergovernmental Relations
House Committee on Government Operations

Mr. Chairman and Members of the Committee:

I am pleased to be here today to share with you the Department's plans for implementing the Student Loan Reform Act of 1993, an important companion piece to the national service initiative. President Clinton's bold new student loan proposal will meet three important goals:

- Make college more affordable for students, through flexible loan repayment terms and lower interest rates,
- Save taxpayers substantial sums of money, and
- Streamline the student loan system.

The Student Loan Reform Act of 1993 is a milestone in the Administration's efforts to reinvent government. It calls for a major revamping and simplification of the Federal student loan system and offers new repayment options to students. By eliminating the middlemen and the excess profits they now receive, the President's proposal will simplify the system, benefit students, and reduce costs for taxpayers.

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You may ask, as others have, why we need to revamp the current student loan system. The answer, simply put, is that the program has become too complex and too costly. In the current program, billions of taxpayers' dollars go, not to students, but to 7,800 lenders, 46 guaranty agencies, and numerous servicers and secondary markets. To its credit, this complex array of participants provides millions of loans to students and their families each year. But they also are paid exceedingly well to do so.

One might well ask when we have such an opportunity to make government work better, who could argue with a plan to provide better benefits to students, while significantly reducing Federal costs, and creating more efficiency? The answer is obvious: those who enjoy substantial benefits from the present system--the banks, guaranty agencies, Sallie Mae, State secondary markets, and others. These groups have hired some of the highest paid lobbyists in town to help them convince you and the public that the President's proposal will not work. What they have been saying is, at best, misleading and often just plain wrong. I have attached to my testimony a list of myths and realities on direct lending that responds to this misinformation.

BUDGET SAVINGS

Direct lending saves taxpayers money. Implementation of the Student Loan Reform Act will reduce the deficit by $4.3 billion over five years and save $2 billion in each subsequent year. Reports from the General Accounting Office and the Congressional Budget Office document the savings to be achieved, even after transition costs. This allows us not only to reduce the deficit but to ultimately pass on savings to students by lowering interest rates for borrowers.

MANAGEMENT IS A TOP PRIORITY

While many have questioned the ability of the Department to manage a Direct Loan program, it will be a far simpler, less complicated system to oversee than the current program. As recently pointed out by the General Accounting Office, the current system's complexity--involving thousands of interactions between schools, lenders, secondary markets, guaranty agencies, and the Department--makes it error-prone and extremely difficult to monitor. The GAO concluded that the "program's structure is not conducive to good financial management."

We at the Department of Education are keenly aware that we must strengthen our management capacity and are working assiduously to improve that capacity. We must do this regardless of whether we move to direct lending or continue the current program. Taxpayers deserve nothing less.

The Secretary and I are bringing together a strong team to manage Direct Loans. David Longanecker, who has been nominated to be Assistant Secretary for Postsecondary Education, is recognized as one of the top experts on student loans in the country and brings with him extensive management experience running state higher education agencies in Minnesota and Colorado. Secretary Riley has asked me to oversee the Department's overall management--a task that I take very seriously. My goal, the Department's goal, is to make Education <u>the</u> model Department in the Federal government. We have asked for the staff resources and technical capacity to make that a reality.

REINVENTING GOVERNMENT

In developing the legislation for the Direct Loan program, we made certain that each key player in the delivery system will

perform those functions that it does best. Schools will deal with individual students; alternative originators and loan servicers will be selected competitively to provide services on the basis of price and quality; and the Department will monitor and oversee the system.

Our proposal will create a new public-private partnership and a simpler system that is more conducive to good management and that is truly competitive. Some critics contend that we are moving away from a public-private partnership to more bureaucracy. This is not accurate. The Department will create a truly entrepreneurial system through competitive contracts for loan originators and servicers. These contractual arrangements will more effectively use the private sector to provide high quality service for a more competitive price. In the current system, we rely on private sector participants who are paid a uniform rate set in statute (T-bill plus 3.1 percentage points) regardless of the quality of their services, rather than a price determined by market competition.

PROMPT DELIVERY OF FUNDS

Under direct lending, the Department will promptly and efficiently deliver loan proceeds to borrowers. Our experience with Pell Grants and the three "campus-based" student aid programs demonstrates that we can deliver funds properly and on time. This year, our system determined the Pell Grant eligibility for over 7 million student applicants and delivered more than $6 billion to 4.2 million students at 6,600 participating institutions. Also, the Department has made available to postsecondary institutions an extensive array of electronic data processing options, including "Stage Zero", which allows a student to use a computer to complete an application with immediate edits for errors. Such advances have saved millions of dollars and thousands of hours of labor, and

eliminated much frustration on the part of our student clients. Building upon this time-tested Pell grant delivery system, we can duplicate this success with the Direct Loan program.

Additionally, our plan for the Direct Loan program will enhance the Federal student aid delivery system by fully integrating the Direct Loan program computer system with the systems that currently deliver Pell Grants and campus-based aid to students and institutions. Students will apply for Direct Loans on the same form--the Free Application for Federal Student Aid--they now use to apply for all other Federal student aid programs, eliminating the burden of separate student loan applications under the current guaranteed student loan system. The student's information will be processed through the Central Processing System. Schools will have access to the Federal funds through the Payment Management System. This same system is the conduit for the other Federal student aid funds that are delivered, through postsecondary institutions, to students. Currently, this system cannot be used for the Federal Family Education Loan programs because of the involvement of guaranty agencies and private lenders.

PUBLIC/PRIVATE PARTNERSHIP

New Contracts for Alternative Originators and Loan Servicers

The contracting strategy for the Direct Loan program calls for awarding several new contracts to support alternative loan origination functions and servicing activities. Alternative loan origination is important because we will not force any unwilling institution to originate loans neither will we permit institutions to make direct loans if they are determined by the Secretary to be incapable of doing so. Loan servicing includes labor-intensive activities such as generating bills and letters, processing borrower payments, reporting to credit bureaus, and

granting deferments and forbearances. To help provide for a "seamless" Direct Loan system, each customer service contractor will be connected to the single loan servicing system database to facilitate establishing loan records, reconciling borrower accounts, and providing a system for servicing loans.

Our plan anticipates the program's growth. It will be necessary to award additional loan origination and servicing system contracts in fiscal year 1995 to support the planned expansion. These contracts will be awarded through full and open competition and contractors will be compensated on a fee-for-service basis. Thus, the marketplace will ensure that we receive the highest quality product at a competitive price.

Our contracting strategy for the Direct Loan program will build on the Department's successful record of managing systems contracts. For example, we implemented on January 15, 1993, as scheduled, the central processing system for the 1993-94 student aid programs. This system implemented many of the statutory changes required by the Higher Education Amendments of 1992 that were enacted July 23, 1992.

Modifications to Existing Contracts

In addition to awarding new contracts to support new activities related to direct lending, five existing Departmental contracts require modifications in order to integrate fully Direct Loans into the current student aid delivery system. These contracts include the--

- Central Processing System to provide software to postsecondary institutions enabling schools to package and originate Direct Loans; additionally, this software will generate borrower-specific loan records for transmission to

the direct student loan servicing system;

- Payment Management System to enable schools to draw down Direct Loan funds for disbursement to students;

- National Student Loan Data System to record borrower-specific data for eligibility screening and for research and analysis activities that can further improve our management of the program; also, when additional loan servicing systems are procured, the NSLDS will perform centralized accounting functions for the Direct Loan program by receiving accounting data from all servicing systems and summarizing it for reconciliation with the Department's primary accounting system;

- General Electronic Support System to provide network services that institutions need to communicate with the Servicing System; and

- Stafford/Perkins Debt Collection System to collect defaulted Direct Loans using more rigorous collection measures including federal income tax refund offset, use of private collection agencies, and wage garnishment.

REQUEST FOR WAIVER AUTHORITY IN EXCEPTIONAL CIRCUMSTANCES

The Department has requested an exemption until 1998 from certain contracting and acquisition requirements. We have done so to ensure our flexibility to respond to emergencies that may threaten smooth student aid delivery or access during the transition. For example, if a guaranty agency were to cease processing without notice, we would need immediate contract support to assist in the phase-out of the agency's loan portfolio. While we plan to fully exercise the normal

competitive process in issuing the contracts that will support Federal Direct Loan delivery, any unforeseen delay could jeopardize our ability to provide financial assistance to students. I must emphasize that we request this exceptional authority only for exceptional circumstances--not for routine circumstances.

The Department also has requested the authority to administer the program during its first year of operation through issuance of Federal Register notices, while notice and comment rulemaking is developed for the long term. These notices would contain standards, criteria, and procedures that the Secretary determines to be reasonable and necessary to successfully implement the program on July 1, 1994 as specified by the Congress in the demonstration program. Again, we would hope our need to exercise this exemption would be minimal.

We have made substantial progress in developing the regulations necessitated by the Higher Education Amendments of 1992 such as those concerning eligibility and other general provisions that we will need for all our programs, including the Direct Loan program when enacted. The Amendments require that we propose most of these through the negotiated rulemaking process, and we have developed these regulations under this very open process.

We fully recognize that in requesting these exemptions, we are requesting your trust. We expect to earn that trust and to be held fully accountable for our actions. Indeed, reinventing government requires that we reconsider our traditional relationships, and we urge you to help us do so in the most productive and efficient manner possible. Our constituents, like yours, are the students, their families, and the taxpayers. Our mission is to serve them well by creating a system that is reliable and provides access to higher education, while demanding accountability.

STAFFING

Our plan for staffing direct loans and the transition from the Federal Family Education Loan programs relies on the trained staff we have in the Department and resources that we will seek through new staff and contractor support. I believe that our plan is realistic and prudent: its foundation is our current staff, who would be augmented over time by new staff with skills and special capabilities not presently available. We will draw on our contractors for any additional support we need, particularly in the labor-intensive data processing and customer service areas. Historically, we have had very positive experiences with contract support in these areas.

Staffing estimates and planned hiring include sufficient numbers of qualified personnel for the Department to manage Direct Loan implementation as well as the transition from the guaranteed loan program. It is important to recognize that the critical period will be the transition when we are phasing in the Direct Loan program and simultaneously maintaining the guaranteed student loan program. In 1994, we plan a staff of 69 for the Direct Loan program, the same number we have already projected for 1994 for the demonstration pilot.

We estimate that a staff of 198 would be necessary for transition activities, some of whom will be Federal employees, some contractor staff. Difficult as it will be, the Department is committed to the President's plans to reduce staff government-wide and we plan to reallocate 30 FTE from other Department programs to the Direct Loan transition effort.

We will use Department staff to monitor and manage contracts, do contract development, perform legal work, and manage the guaranteed loan defaulted debt portfolio. Our plan calls for

contracting for the special capabilities needed to help develop procedures, and manage the phase-out. Thus, Department staff would retain policy and management functions.

The recently implemented reorganization of the Student Financial Assistance Programs, which, among other changes, resulted in centralizing program gatekeeping functions in one unit, makes this possible. All system design and development functions that previously were scattered among several divisions are now consolidated in one service. With this new structure, we have measurably improved the accounting and financial controls over the student financial aid programs.

ENSURING A SMOOTH TRANSITION

Our plan has a number of features designed to ensure a smooth transition from the current guaranteed loan structure to the new Direct Loan program. Our purpose is clear: to assure access to loans for all students who qualify; and to maintain total stability in the student loan system. While retaining a system of financial incentives and payments, we have added new provisions designed to protect the Federal investment in the student loan program. All current benefits to lenders and guarantors are retained with respect to outstanding loans. Lenders that make new loans during the transition will continue to receive interest subsidies and 100 percent insurance against borrower default. Payments to guarantors for their administrative costs are continued, but the new allowance is based on the size of their loan portfolios and will support continued operations as new loan volume diminishes. The Department is authorized to pay guarantors a fee to find lenders for students who cannot find a lender on their own. Additionally, the Secretary may require Sallie Mae to make "lender of last resort" loans.

The Department is empowered to intervene quickly if a guarantor fails or withdraws from the program. The public interest in guarantor reserves is protected by codifying court decisions that these reserves are under strict Federal control and are to be used only for Federal student loan purposes. The plan would also prevent guarantors from seeking bankruptcy protection or trying to interfere with proper control of Federal assets through the State courts.

We have carefully considered the transition needs for this effort, and we feel confident that our plan addresses these needs. We will take any additional steps that may be necessary to ensure an orderly transition from the Federal Family Education Loan Program to the Federal Direct Student Loan Program.

RELATIONSHIP TO THE DEMONSTRATION PROGRAM

Opponents have suggested that we wait for the Federal Direct Loan Demonstration program, authorized last year, to show results before we move toward full implementation. There are a number of reasons why we have decided to view the first year of the program as the first phase of full implementation rather than a demonstration. It would take up to ten years or more to obtain results from the demonstration program. Even then, we would not have the accurate results needed to determine whether direct lending can succeed because, with such a small number of schools participating, it will be impossible to achieve economies of scale. Most importantly, given that we know that direct lending will result in savings, it would be wasteful to use a demonstration program to test this principle. Instead of testing whether savings are achieved under the demonstration program, phase one of direct lending will allow us to test implementation issues on a reasonable time schedule. We will start small, with only four percent of new loan volume in the first year. This

number is manageable but large enough to give us initial feedback on implementation issues. We will move to 100 percent only in the fourth year. Each year, we will conduct an evaluation and provide a full report to Congress. We will watch our progress carefully, and if things need to be altered we will do so. We assure you that we will notify you promptly of obstacles, as they arise.

CONCLUSION

In concluding this testimony, I would like to reiterate my firm commitment to strong and effective management of the new Direct Loan program. Many of the well-tested systems for delivering funds are already in place and will be used to ensure efficiency. We have a plan that includes all the elements essential to success: strong over-all management, contractor and systems support, additional employees, and a Department-wide commitment to provide this support. A transition plan has been carefully developed that is sensitive to the needs of our students and our institutions.

I hope this dialogue is a step toward earning your confidence that the Direct Loan program will be in capable hands. This proposal is the product of many months of intense debate, deliberation, and careful planning which included the President's Domestic Policy Council, the Office of Management and Budget, the Treasury Department, and the Internal Revenue Service. Hundreds of individuals and associations were consulted in extensive outreach efforts. We believe strongly that the proposal will benefit students and taxpayers.

We are very aware of the heavy responsibility we are assuming and of the legacy of poor management we must shed. We are determined to carry the public trust in such a manner that will make you proud of the Department of Education.

UNITED STATES DEPARTMENT OF EDUCATION
WASHINGTON, D.C. 20202

DIRECT LENDING

MYTHS vs. REALITIES

MYTH: Direct lending saves money by shifting costs to colleges and universities. Institutions will face substantial costs for originating, servicing, and collecting student loans.

REALITY: Direct lending saves money in two ways:

- cutting out excess profits
- using Federal borrowing

The only new activities required under direct lending will be origination of loans and reconciliation of the amounts disbursed.

- institutions will receive a fee from the Department of Education if they originate loans and,
- an alternative originator will be available at no cost for institutions who do not originate loans

MYTH: Institutions do not have the capacity to administer direct lending.

REALITY: Many institutions can easily administer direct lending system.

- Schools participating in current loan programs already determine eligibility, counsel students, and disburse loan funds.
- Schools participating in the Pell Grant program already draw down funds electronically from the Education Department to the students.
- Schools participating in the Perkins Loan program already administer loans to students through the financial aid office.
- Direct lending will be easier than Perkins Loans because schools will not be responsible for servicing or collecting loans.

Those institutions which do not have the capacity to administer loans will use the services of alternative originators at no cost.

MYTH: Direct lending substitutes a federal bureaucracy for the efficiency of the private sector.

REALITY: This proposal will build a new public/private partnership to select contractors, who will compete on the basis of price and quality, to act as alternative originators and to service loans.

MYTH: Loan availability will be delayed if the debt ceiling is not raised.

REALITY: When total federal debt reaches the debt ceiling, Congress must raise the ceiling to finance any and all government operations. If the debt ceiling is not raised, all government operations--not just student loans--will be at risk.

MYTH: Entitlement to loans for students will be lost.

REALITY: Students will continue to have access to the same amount of loan capital as they have now. They will also enjoy more flexible repayment options and lower interest rates.

MYTH: Department of Education cannot manage the current system. A new, untried system will be even more difficult.

REALITY: The Department must strengthen its management capacities and we are investing heavily in management improvement. We will improve management regardless of whether we move to direct lending. But, this new streamlined program will be easier to manage. We have experience with a direct loan program, the Federal Perkins Loan program, and we know it works and that institutions can run it.

MYTH: The savings attached to direct lending are overestimated because estimates do not accurately account for administrative costs.

REALITY: We have included generous allowances for administrative costs in our budget estimates. We have included costs for direct loans as well as estimates of costs associated with the transition from guaranteed loans to direct loans. We save money because the government has a lower cost of funds and we eliminate excess profits.

MYTH: It is irresponsible for the Administration to abandon the demonstration program in favor of full implementation of direct loans.

REALITY: We are phasing direct lending in over four years so that we can watch the process carefully and make changes as necessary. We will start with four percent of volume the first year, roughly the size of the demonstration program. Each year we will evaluate our progress and report to Congress.

MYTH: Federal borrowing will skyrocket and push borrowing rates way up.

REALITY: Although national debt will increase as federal borrowing replaces private capital, overall debt in the economy will not increase and the national deficit will decline by $4.3 billion over the next five years. In the future, the government's need to borrow for direct lending will be less than it would be if the current program continued.

MYTH: Direct lending will allow unscrupulous schools greater access to federal funds and drive up default costs.

REALITY: The Department of Education will monitor schools closely and will develop strict criteria measuring financial and administrative capacity to determine which schools can originate and which will be required to use the services of alternative originators. The Department is also beginning the new state review process to improve institutional oversight.

Mr. TOWNS. Thank you very much. Your testimony was very informative; and let me add that we know of your great work prior to coming to this position, and we have always held you in high esteem and have a lot of respect for you.

One bright factor over at the Department is the fact that you are there. We hope that as a result of your presence—even though there are very difficult problems, we hope that you will be able to make it work.

Let me ask you this. Do you agree with the GAO that it is imperative that the Department have a master plan before it proceeds?

Ms. KUNIN. Absolutely, and we are in the process of developing an overall strategic plan.

The Department held a retreat about 3 weeks ago. We are now putting the pieces in place for an overall strategic plan for the Department. At the same time, we are developing a master plan for the implementation of direct lending.

I would ask your consideration in light of the fact that the legislation has not yet passed, so that it is impossible to construct the kind of detailed line-by-line, moment-by-moment master plan that will be necessary. But once the legislation is adopted, David Loganacre, this team that is with me, the Secretary himself, will oversee that master plan. We are not going to leave anything to chance. We are thinking this process out step by step and day by day.

Mr. TOWNS. Thank you.

The ranking member, Mr. Schiff, has yielded to Mr. Sanders from Vermont. I guess he did it because he recognizes that you have some connections and some ties with Vermont.

Mr. SANDERS. Sure. She beat me in 1986. We are delighted to welcome Governor Kunin here, who has long been active in education in the State of Vermont; and we are very confident she is going to continue her excellent efforts here in Washington.

The point I would like to make, Mr. Chairman, is that what we are really talking about today should be put in a broader perspective. The perspective that should be discussed is that it is a national disgrace that in the United States of America and in our own State—I go around to a lot of high schools in Vermont—you have millions of young people in this country who want a college education, who have so much to offer this country, but who are, simply because of the financial circumstances of their families, unable to get that college education. I am sure you would agree with me that there is something lacking in our Nation when every young person or every person of any age does not have all of the educational opportunity that he or she needs, both for the good of the Nation as well as the individual.

That is the context in which I think we should be discussing this issue.

Within that context, I think, Governor Kunin has indicated this country has a huge deficit. We have problems of access to higher education. And some of us do not believe that the limited amounts of money that we have for education should go into bureaucracy, should go into bank profits, rather than into the needs of our young people and into the protection of our taxpayer.

I think the point that Governor Kunin made is, this is a simpler program. It is a less complex program, which means there are going to be more savings for the taxpayer and also, I think, make it easier for the student. Maybe Governor Kunin can say a word—something I find as somebody at the end of sending four kids to college, getting access and learning what kind of opportunities are available is very complex; and many young people go out there, and they really don't know what is available. And my guess is, if we simplify the system, the young people of America and their parents will learn more about loans and grants and so forth and so on than is presently the case.

Would you agree with that, Governor?

Ms. KUNIN. Yes, I would, Congressman; and in a number of ways, I think it would make life easier for the student, for those colleges that choose to do direct lending—and as Congressman Andrews pointed out they don't have to do direct lending if they don't feel equipped to. They can obviously deal directly with the loan officer at the school who can handle their whole lending portfolio if that is the route they choose to go. They will have an easier payback period by choosing the income contingency route, if they wish to do so. And that also would avoid some students going into default if they go through a rough period. Income contingency also makes it possible to take lower paying or public spirited jobs. There will be a financial savings for the student. There will be a half percent reduction in the interest rate. There will also be an initial reduction in the initiation fees to the student.

As much as possible, we see this as a way to simplify the process for the students, as well as for the institutions, and save some money and put it both in deficit reduction and, hopefully, to a greater extent as the program moves along, into higher education.

Mr. SANDERS. Thank you.

Mr. TOWNS. Mr. Horn, if it is brief, we can probably do it.

Mr. HORN. One brief question and one brief insert into the record.

Thank you very much for your testimony. I have noted your work with high regard over the years. We are delighted to see you in Washington.

Does the Department of Education favor collection of direct loans through the IRS income tax system?

Ms. KUNIN. What we have in the bill right now is for the IRS to share income information to verify the income contingency plan. Then there is a study that says after 6 months the Secretary of the Treasury and the Secretary of Education shall produce a report that says how they will do it. I think the understanding is, and the implication is, yes, the IRS will be involved, and we do favor it; but the reason for the study is, we want to make sure that it is done right. The IRS has to gear up its computer system, its capacity.

But we certainly think it is very appropriate; as you improve access, you also have to improve responsibility. If you get a loan, if you can pay it back slowly, you should be sure that you do, in fact, pay it back. This is taxpayers' money.

Mr. HORN. I agree with you, and I hope you all pursue. In the meantime, Mr. Chairman, with your permission, I would like to include in the record a statement and analysis which the Association

of Governing Boards of Universities and Colleges has made. I think it is very interesting. It is a very responsible analysis. We just might have the whole picture that way.

Mr. TOWNS. Without objection.

[The information follows:]

Association of Governing Boards
of Universities and Colleges

DIRECT LOANS: An Assessment of the Clinton Administration's Proposals and Some Suggestions for Improvement

By Arthur M. Hauptman

AGB PUBLIC POLICY SERIES
No. 93-1

Appendix: Will Direct Loans Save the Federal Government Money?

A number of the groups who profit from the current guaranteed student loan structure not surprisingly have led the charge of describing the savings estimates associated with direct lending as dubious. This appendix explains why there is nothing dubious about the savings from direct loans and reviews several of the studies which have been distributed to dispute these savings estimates.

To understand the debate over the potential for savings from direct loans, it is important first to understand the credit reform rules that were passed as part of the 1990 Budget Enforcement Act. Prior to credit reform, all federal spending for loans was accounted for on a cash and current basis; revenues and spending were recorded on the federal books on the basis of the year in which they occurred.

This traditional federal accounting procedure tended to bias federal decision making in the direction of guaranteed loans since one year's worth of interest payments were the only spending that would show up on the federal books in the year the loan was made. All of the federal payments for interest and potential defaults which that loan would require in the future thus were not shown in the federal budget when the decision was made to make the loan.

By contrast, the capital required to make direct loans appeared in the year it was made under the old accounting rules, while the repayments that would come back to the government from having made that loan would be hidden in future year budgets. This accounting procedure helps to explain why guaranteed loans mushroomed over the past quarter century to become the principal source of college student finance in this country, while Perkins Loans have languished as a relatively small federal aid program.

Credit reform seeks to remove this traditional bias by putting direct loans and guaranteed loans on a more equal budgetary footing. Under credit reform rules, all federal loan costs are accounted for on the basis of the present value of the payments or subsidies that the government provides over the life of the loan. In the case of guaranteed loans, this means that the interest and default payments that occur over the life of the loan are estimated and discounted to a single sum at the time the loan is made. For direct loans, the federal cost under the credit reform rules is the present value of the difference between what the government earns on a direct loan compared to its costs.

It seems fair to say that without credit reform the recent debate over direct loans would not have occurred because the old accounting rules would have always shown direct loans to be more expensive than privately financed student loans. With credit reform, direct loans became a much more attractive option to federal policy makers.

Under credit reform, the federal savings from direct lending accrue in two forms. While a borrower is in school, the savings are the difference between what the government currently pays to borrowers (T-bill plus 3.1 percent for new borrowers) and the government's cost of money (T-bill), times the number of years in school. This comes to about 6 cents per dollar loaned, assuming that borrowers remain in school an average of two years. For the many borrowers who remain in school for more than two years, the potential federal savings from direct loans are much larger.

The other component of federal savings on direct loans comes during the repayment period in that the government in essence will make a profit under direct lending. The amount of these profits/ savings equals the difference between what the borrower repays (T-bill plus 3.1 percent), and the cost to the government of T-bill plus the costs related to servicing (which under any reasonable reimbursement scheme would not exceed two percent of the face value of the loan). Thus, the federal savings during repayment should equal at least one percent of the outstanding value of the loan times the number of years in repayment, again discounted back to present value. This comes to about 4 cents per dollar loaned.

When the federal savings during the in-school period are combined with savings that occur in repayment, the total savings from direct loans thus equal roughly 10 cents per dollar loaned. The total federal costs of guaranteed loans at current interest rate levels are roughly 20 cents per dollar loaned, so that direct loans are estimated to save roughly half of the current costs. The largest remaining cost would be for the federal costs of defaults.

A number of recent studies have disputed these estimates of the federal cost savings from direct loans. The most prominent of these studies was published by the Congressional Research Service in February 1993. Entitled Federal Family Educational Loans: Reduced Costs, Direct Lending, and National Income, this study has been widely distributed and quoted by opponents of direct lending in large part because it argues the direct lending will not save the federal government any money. It also is the case, however, that the basic conclusion of the CRS report agrees with the proponents of direct lending, namely, that there are excess profits in the existing federal student loan programs.

The argument in the CRS paper is based on several curious assumptions and findings. The first curious assumption is that the federal student loan programs provide a competitive rate of return to the banks and others who participate in the program. The history of the federal student loan programs runs directly contrary to this assumption: rather than let the market determine the price, virtually all features of the programs are set through statutory and regulatory provisions. If the terms and conditions in these programs had been set by market forces, it is possible that much of the current controversy over direct loans would not be occurring.

A second assumption underlying the CRS report is that any shift in reliance from the private sector-based current structure to one in which the federal government provides the capital would result in no net increase in national income. That is, in the report's words, "any increased funding available for public spending would be exactly offset by reduced private sector income". While this is most likely true, it is not clear why the fact that national income would not increase should deter policy makers from squeezing excess profits out of the current system to the benefit of the taxpayer or the student. If this criterion of net national income gain were used in the analysis of other public policy issues, many worthwhile reforms would be judged ineffective, including health care reform and federal housing program changes.

The CRS assumption that has received the most discussion is the notion that a squeezed down current structure could produce as much savings as the proposed shift to direct lending. It certainly is the case that some level of reduction in the rate of return on privately financed student loans would equal the savings generated by direct lending. What the CRS report seems to ignore, however, is that the current participants the student loan programs always have resisted changes that would have netted far less in federal budget savings that what could result from direct lending. The banks and others are now coming forward with proposals that would yield substantial savings, but they are only doing so because of the threat presented by direct lending.

A number of private studies, which have been commissioned or conducted by organizations that profit from the current system, not surprisingly suggest that direct lending will not result in the level of federal savings indicated by the Administration and supported by estimates of the General Accounting Office and the Congressional Budget Office. One such study was conducted by Rudolph Penner, former director of the Congressional Budget Office, now an economist with KPMG Peat Marwick. This study was prepared for the Coalition for Student Loan Reform, a misnamed ad hoc group of guaranty agencies and others with a clear stake in maintaining the status quo.

The principal contention of the Penner study is that direct lending will not save the government money because the government's cost of borrowing will increase from the additional debt it will need to incur in order to provide the capital for student loans. But the capital markets for public and private capital have become increasingly homogeneous over time, with the result that interest rate differentials reflect risk variances rather than changes in the mix of public and private debt. There is an active debate now underway about whether increases in government debt lead to a narrowing in the interest rates paid on public and private debt issues, with reputable economists on both sides of this issue.

Moreover, in the absence of direct loans, the government will still need to borrow money to subsidize the banks and others who make privately financed loans. Currently, the federal government borrows about $5 billion a year to make interest and default payments in the current student loan programs. Unlike direct loans, which become self financing once repayments equal the volume of new lending, the borrowing that the government needs to make subsidy payments for privately financed loans are never repaid.

Thus, at some time in the future, the amount the government borrows to finance the payments to lenders of privately financed loans will exceed the amount of borrowing needed to provide the capital for direct loans. The Penner study estimates that the amount of accumulated government borrowing to pay for privately financed loans will exceed the borrowing needed to finance direct loans by the year 2004, although the interest on this accumulated government debt through subsidies paid to private lenders does not appear to be included in the cost analysis. It appears that within ten years of implementing direct loans, even critics agree that the government's need to borrow under direct lending will be less than it would be if the current program were to continue as it is.

Another issue raised by Penner is the current difference between short-term and long-term Treasury rates and the impact it could have on the cost estimates associated with direct lending. Currently there is roughly a two percentage point rate difference between the 91-day Treasury bills and the 10-year Treasury bonds. Penner and others have pointed out that if the 10-year bond rate were used as the estimate of the government's cost of money under direct loans, rather than the 91-day Treasury bill rate, then most of the government's savings would be eaten up by this difference.

This assertion is correct if the Treasury were to use 10-year bonds to finance direct loans and if the difference between short-term and long-term rates remains at two percentage points in the future. But the Treasury would try to avoid such a disadvantageous spread situation just as private lenders do now. Also, two percentage points is a very high differential between short-term and long-term rates by historical standards, and this differential is more likely to narrow than expand over time. With such a narrowing in market interest rates, the cost consequences for direct lending would sharply diminish as well.

Penner in a separate study for the Coalition complains of the difficulty in estimating federal costs under credit reform, pointing particularly to the fact that interest rates will change over time in unpredictable ways. This argument about estimating difficulties is ironic since Penner was supportive of credit reform while at CBO, and most other reputable economists believe that the shift toward credit reform represents a substantial improvement in federal budget procedures.

Another recent study, entitled The Bottom Line, suggests four reasons that no federal savings result from direct loans. Perry Quick, an economist with the national accounting firm of Ernst and Young, directed the study, which was commissioned by USA Funds, a national guarantor and servicer of federal student loans which stands to have sharply diminished revenues under direct lending.

First, the Quick study cites the decline in market interest rates since GAO and CBO did their analysis. But if anything, lower interest rates should lead to greater savings since the discount rate will be lower yet the dollar differential between direct lending and privately financed student loans will remain the same.

Second, Quick asserts that the CBO and GAO cost estimates of servicing and administration in their analysis of direct lending are too low because they use the costs faced by Sallie Mae. But the market-based costs of contracting for servicing now run about $40 per year, which is roughly the figure used by CBO and GAO. Quick also includes a cost of approximately $25 per loan during the in-school period when all the lender has to do is bill the government four times a year for its interest payments. In short, the estimates of servicing costs used in this and other studies seem wildly high, and seem to reflect more the bias of the sponsors than the actual costs of doing business.

How to account for the costs of administration has been a particularly contentious issue in the direct lending debate. The credit reform accounting rules require that administrative costs (including those for servicing) be accounted for on a current year basis, rather than the discounted present value of a stream of payments calculation that is used to estimate other program costs.

CBO, in response to a request by Senator Pell, more recently has indicated that if administrative and servicing costs were included in the calculation of a discounted stream of payments, the five year savings from direct loans would be much lower than previously indicated. Opponents of direct lending will argue that this more recent CBO analysis confirms their longstanding contention that direct lending will not save the federal government nearly as much money as what its proponents have argued.

What this argument over administrative costs most confirms, however, is the importance of focusing on the long term savings from direct loans rather than looking only at the annual savings over the next five years, a figure which can be manipulated in a number of ways by proponents on both sides of the issue. On a long term basis, administrative costs, including paying institutions and others for loan origination, offsets only a small portion of the savings from direct loans. When administrative and servicing costs are subtracted from the savings related to interest rate differentials, the total federal savings from direct loans still amount to about 8 cents per dollar loaned.

A third assumption included in the Quick study is that default costs will increase under direct lending. This may or may not be true, but none of the government's cost estimates for direct lending assume any change in default costs in order to maintain an apples-and-apples comparison between direct and private lending. Nor do the government's estimates of direct loan cost savings include any savings resulting from income-contingent repayment options, again for reasons of keeping the estimates comparable.

The final Quick assumption is the same as that of Penner, namely, that the government's cost of borrowing will increase under direct loans. While this argument has the truest ring of any of the points in the Quick analysis, the realities of current day capital markets mentioned earlier in response to the Penner study raise doubts about the validity of arguing that additional government borrowing increases its cost of capital. As was also mentioned previously, reasonable economists differ on this point. Perhaps the most persuasive argument in this regard is that, in the 1980s, the amount of federal borrowing increased considerably relative to private debt, yet the interest rate differential between public and private debt issues did not narrow appreciably.

ABOUT THE AUTHOR

Arthur M. Hauptman has been an independent consultant since 1981, specializing in issues relating to higher education finance and federal budget policies. Recently, he has written on reforming student-aid programs, the growth in college tuitions and costs, and the financial condition of American higher education. He previously served on the staff of the U.S. House Budget Committee and the U.S. Senate Labor and Human Resources Committee. Hauptman received a B.A. from Swarthmore College and an M.B.A. from Stanford University.

Mr. TOWNS. All right. Let me thank you, Mr. Horn, our in-house expert. He is a former college president, so he has been involved with these issues for many, many years.

Madam Secretary, let me thank you very much for your testimony this morning; we are not going to hold you any longer, we are going to run over to vote. We are looking forward to working very closely with you and trying to bring about some real changes.

Mr. Sanders mentioned the fact that what we really want to do is to get as much money out there for the students to enable them to get an education, rather than have the money be used up in administrative ways; so that is a real, real concern.

I have some concerns on this side that we are going in such an expedited manner that some people feel that direct lending should be phased in. We are not sure what we are dealing with and we could have a tiger by the tail.

Thank you.

Ms. KUNIN. Hopefully, you won't have a tiger by the tail; we will phase it in prudently. But if you have questions as we proceed, please call upon us at any time. If you need more information, we will be delighted to supply it.

Mr. TOWNS. Thank you very, very much.

Ten-minute recess.

[Recess taken.]

Mr. TOWNS. Our final witnesses today will be Ms. Sturtevant, Dr. Forbes, Mr. Butts, and Ms. Bloomingdale. Ms. Sturtevant is director of financial aid at Emory University and is representing the National Association of Student Financial Aid Administrators. Dr. Forbes is the vice president for student affairs for the University of New Mexico. Mr. Butts is associate vice president of government relations for the University of Michigan, representing the National Association of State Universities and Land Grant Colleges. Ms. Bloomingdale is representing the U.S. Students Association, a very important group.

This is an investigative subcommittee. So I am going to ask each of you to swear to or affirm an oath. So if all four of you would now stand.

[Witnesses sworn.]

Mr. TOWNS. Let the record indicate that each of the witnesses has answered in the affirmative.

I would like to thank you for testifying today. We have your prepared statements, and we will enter them into the record. We appreciate very much if you will summarize your statements within a 5-minute period. This will leave the members time for questions.

So why don't we start with you, Ms. Sturtevant.

Mr. SCHIFF. Mr. Chairman, excuse me.

I want to express a special appreciation to you regarding the fact that at least two of the witnesses, Dr. Forbes, University of New Mexico, and Mr. Butts from the State of Michigan, were proposed by myself or other minority members.

And I just want to express—since you have the final say, as we all know—I want to express a special appreciation for your willingness to include suggestions and witnesses from our side of the aisle.

Mr. TOWNS. Let me thank you for your involvement. We try to bring strong witnesses. And of course, when you know that somebody is out there who has information, we definitely want to hear from them. Thank you for recommending them.

Ms. Sturtevant.

STATEMENT OF ANNE STURTEVANT, DIRECTOR OF FINANCIAL AID, EMORY UNIVERSITY

Ms. STURTEVANT. My name is Anne Sturtevant. I am the director of financial aid at Emory University in Atlanta, and I am representing the National Association of Student Financial Aid Administrators [NASFAA]. I appreciate the opportunity to be invited today. This is a very important hearing, and we are pleased that you have called us together.

As you know, the Federal family education loan programs provide the single largest source available to help students and parents pay for postsecondary education.

The fact that it is so large, I think, is why when suggestions are made to change it, even slightly—but particularly significant changes—that aid officers tend to become uneasy because so many families are dependent on these programs.

It is that uneasiness that I believe has caused widely differing views on what we should do now: Improve the current delivery system of student loans or get rid of it and go into direct lending.

This uneasiness is why NASFAA adopted a position in 1991 and reaffirmed it recently in favor of implementing a parallel direct loan program that would be of sufficient scope to truly analyze side by side the advantages and disadvantages of the current delivery system of student loans, compared to direct lending.

One of the things I think you should be aware of is that many State financial aid associations, as well as regional financial aid associations, strongly oppose full implementation of direct lending without thorough testing. And they are on record as doing so.

I was interested in what Mr. Andrews said earlier this morning about, well, we are phasing it in. It is not full implementation, and the importance of a pilot.

And I wanted to share with you a quote from a colleague, Tom Rutter, who is the director of financial aid at the University of California, San Diego: "We oppose dismantling a system that works until we are confident that an alternative system is both better for students and less expensive for taxpayers. We seek the same goals as the President, but we oppose rushing into this untested and unproven solution."

Somebody mentioned facts versus assumptions, and I think this plays into it the same way.

Another thing that I think about is that most of us have been in situations where we have done something manually and then there is an opportunity to automate. But I don't think many of us would totally abandon a manual system for an automated system without running it parallel. There are too many systems to work out. If you abandoned your manual system, you would be left with no alternatives and no way to support your students.

If direct lending is the choice that our government makes, NASFAA wants to make it work. We are in the business of serving

students. And the last thing we would want to do is put an obstacle in front of that.

We have met with the Department of Education and have indicated our full support of the Department and will cooperate in any way that NASFAA and its members can, so that if direct lending is the decision that is made, we can ensure its success.

We have shared some of the concerns that member institutions have about the Department's capability to administer this program. I personally did not agree with Mr. Andrews's statement that the Department of Education would not be running this, that, in fact, it would be contractors and servicers and a partnership between private and public.

Speaking from a school perspective, to us it feels like total government control. We don't have a lot of influence with the Department of Education or with Congress. Right now we have quite a bit of influence with our guarantee agencies and our lenders.

From our perspective, it still seems like full government control. And to entrust the financial well-being of our students to something that hasn't been tested feels very risky to us.

Just as an aside, NASFAA has a survey network that it exercises occasionally. It is a statistically based cross sample of the entire membership. And when survey results are needed, this rapid survey response network is used to ask members how they feel about the issues. NASFAA's position on direct lending is a result of a survey that was conducted.

Most of the members that were surveyed in a recent poll feel the same way, that direct lending ought to be fully tested. As a personal observation, the best reason to test before going full phase is that there is bad faith among the community of aid administrators and the Department.

If there were not bad faith, then we would have jumped on the bandwagon long ago. This is a great opportunity for students and a great opportunity for the country. But the fact that there has been this history of unfulfilled expectations, has made the aid community very concerned about giving even more control over to the Department of Education when it again puts at risk the lives and well-being of our students.

We have some specific concerns that are outlined in our written statement having to do with the planning process and ensuring that the aid community is fully involved. And I mean sincerely involved.

I would be happy to answer any questions, and I thank you very much for this opportunity to speak with you.

Mr. TOWNS. Thank you.

[The prepared statement of Ms. Sturtevant follows:]

Statement of

The National Association of

Student Financial Aid Administrators

Before the House Subcommittee on

Human Resources and Intergovernmental Relations

Presented by

Anne Sturtevant
Director of Financial Aid
Emory University
Atlanta, Georgia

June 10, 1993

Mr. Chairman, Members of the Subcommittee: On behalf of the more than 3,100 institutional members of the National Association of Student Financial Aid Administrators (NASFAA), thank you for inviting us to appear before you today. My name is Anne Sturtevant and I am the Director of Financial Aid at Emory University in Atlanta, Georgia. I am here today to represent the National Association of Student Financial Aid Administrators (NASFAA).

We appreciate the opportunity to provide you with our perspective on issues related to federal direct lending. At the outset, let me say that most financial aid administrators clearly recognize that the existing Part B student loan structure is unnecessarily cumbersome, besieged with unnecessary regulations, and difficult to manage. However, in spite of these deficiencies, the Federal Family Education Loan Programs (FFELP) are still the single largest source of funds available to assist students and/or their parents to help pay for postsecondary education. As such, when suggestions are made which would cause significant changes to the operation or structure of the programs, many financial aid administrators become uneasy about the programs' stability. Aid administrators question whether or not the proposed replacement would provide the same levels of funding and levels of service that exist under the current scheme.

In large part, this is why, when discussions of direct lending arise in meetings of financial aid administrators, there are such widely differing views on how to best improve the current system or whether to adopt and implement a completely new approach to delivering and financing student loans. These differences of opinion weighed heavily in the discussions undertaken by NASFAA's Board of Directors in formulating its position on the issue of direct lending.

Clearly, most financial aid administrators believe that there are many positive aspects in the direct lending concept, while at the same time, they are concerned that moving too quickly with full implementation without time to plan, implement, evaluate, and assess the direct lending model could result in disruption and delays in delivering loan proceeds to students and in loan servicing and collections.

That is why NASFAA, as well as many other organizations, established a list of principles that must be considered and achieved in order for a direct lending program to succeed. It is also why NASFAA reaffirmed the position it adopted in November of 1991 in support of developing and implementing a parallel direct loan program of sufficient scope to allow for a complete evaluation that would complement rather than supplant other forms of student aid.

Further, the Association also has called for special attention to the need to assure adequate capital as an essential underpinning of any federal student loan program, to insure that educational opportunity for all qualified students will not be thwarted. At the same time, NASFAA understands the difficult decisions that needed to be made to achieve the mandated reconciliation reductions to the federal student loan programs and its members support delivery of loan funds to students through the most efficient

and cost-effective means possible. As noted, opinions differ as to whether modifications to the current system or a new system of direct lending would accomplish that goal.

Still, if direct lending is the choice, we want to see it work. We have informed the Department of Education that we will cooperate with them, and lend our full support in insuring that direct lending is successful if this is the legislative approach that is approved by the Congress. At the same time, we have shared with Department officials the deep concerns that a majority of financial aid administrators have expressed involving a lack of confidence in the Department's ability to satisfactorily carry out its responsibilities in a timely and efficient manner.

The basis for these concerns is, in large part, the Education Department's past failures to produce reasonable regulations and to distribute them in a timely manner. In implementing other major policy initiatives, the Department has all too often failed to factor in assurances to meet student and institutional needs, and has shown a rigidity in approaches to problem solving that fail to consider differences in schools, academic calendars and course offerings, and levels of administrative support and capacity.

These concerns were most recently substantiated by the results from NASFAA's survey on direct lending. The Association's Rapid Survey Network is composed of a statistically representative sample of NASFAA member institutions. NASFAA recently utilized it to gather information on a number of questions about direct lending. A copy of the survey instrument is attached to my statement and relevant points are included in the remainder of my testimony. The majority of responses obtained align with the Association position to proceed with the demonstration program before moving to full-scale direct lending. Further, of the numerous issues offered for comment, survey respondents expressed the most concern about two items directly related to the Department's administrative ability. These included: the Department's ability to issue regulations on direct lending in a timely manner; and the Department's ability to provide needed training and support. Of only slightly less concern to NASFAA members was the Department's ability to adequately perform loan collections and servicing with contractors, followed by concern that current levels of service provided by lenders would be reduced under the Department's administration of the program.

As these results clearly show, many NASFAA members are apprehensive about phasing out the current Part B loan programs and replacing them so quickly with an untested full-scale direct lending program. Part of their anxiety is due to the fact that many aspects of the new program are unclear. Institutions are unsure how the new program will work, what will be required of schools, whether or not adequate levels of needed capital will be assured and delivered promptly, and what kind of financial liability institutions will face. In fact, the Administration's bill and the reconciliation legislation approved by the House, grant the Secretary of Education wide authority to

define the Federal Direct Student Loan Program. This broad, undefined Secretarial discretion, particularly in light of the recent GAO management report (titled *Long-Standing Management Problems Hamper Reforms* and issued in May 1993), does little to ease campus aid administrators' anxiety concerning how the new program will work and what will be required of schools. On the other hand, this GAO report was based on a review conducted between December 1990 and September 1992. Clearly, this was prior to the installation of the current management team and thus, is largely based on chief administrators no longer employed at the Department. Even so, given the state of affairs within the Department that Secretary Riley and Deputy Secretary Kunin inherited, one might question whether problems of this magnitude can be overcome in such a short timeframe as to permit smooth implementation of a direct loan program.

If it is to be accomplished however, then we believe that special attention must be given to the following functions.

Planning and Testing. First of all, we must emphasize the critical importance of adequate planning and testing. Some events relative to the 1992-93 delivery system may have relevance. Pursuant to the Higher Education Amendments of 1992, the Department was required to implement a modified delivery system structure. While preparation began prior to enactment of the law, this process began in earnest in mid-July of 1992, and was operational in early 1993. We commend the Department staff for their diligent efforts to accomplish major revisions in a relatively short timeframe and acknowledge that much of the community's displeasure with the 1992-93 delivery system was due to disagreement with legislative requirements and was unrelated to the Department's administrative abilities.

Nonetheless, for whatever reason, the Department made several uninformed or hasty decisions that caused processing delays for substantial numbers of students at postsecondary institutions across the country. This year, application records of thousands of students were inappropriately routed because the system implemented by the Department did not provide adequate safeguards for identifying and designating institutions to which information was to be sent. While this procedure is expected to be improved for next year, one can still speculate about whether the problem could have been avoided if thoughtful preparation and more community input had been sought before proceeding with the whole process.

Given this latest experience, we believe that it is imperative that the Department obtain input from the financial aid community to develop procedures and regulations to guide a direct lending program. Although the Department has received comments on the proposed rules for the demonstration program, those rules were issued when the Department was still in the "preliminary stages of developing the FDSLP [Federal

Direct Student Loan Program] systems and procedures" which were neither "complete nor in final form." Institutional administrators must have an opportunity to evaluate fully executed plans, not just sketches.

Therefore, we would encourage the Department to appoint an ad hoc representative group of institutional administrators to work closely with the Department to thoroughly explore and develop both the operational and policy issues to be utilized with any direct loan program.

Developing the Process. The actual beginning of the process varies depending on one's perspective. For schools, an understanding of the participation criteria is essential to making the determination about whether to take part in the program. Without a clear delineation of institutional responsibilities, it is difficult if not impossible to assess the potential risk for institutional liabilities. Schools' potential liability was a major issue of concern to our survey respondents. Therefore, we would encourage the Department to spell out in specific detail who will be responsible for which operational requirements, and the criteria by which participating schools will be evaluated to assess non-performance and the likelihood of any financial liability.

Another process issue is how schools are allowed to participate. Seventy-three percent of our survey respondents preferred to participate in both a direct loan program and the Part B programs until such time as the Part B programs would be phased out. Further, more than 50 percent believe that new borrowers should be phased into the program, thereby allowing current FFELP borrowers to continue under existing programs.

We believe both of these issues should be carefully considered before proceeding with the current plan which would require participating schools and all of their students to just receive loans under the new direct loan program. Clearly some schools would prefer to just operate one set of programs. But others might be more willing to agree to initially participate in direct lending, if they can still have access to the existing FFELP for some of their students.

Another process issue is to insure an appropriate interface with the current student aid delivery system. For the statutorily-authorized demonstration program, the Department planned to utilize the Free Application for Federal Student Aid (FAFSA) and the existing Central Processing System (CPS). This mechanism seems reasonable, but, again, how records will be transferred from the CPS to institutions must be carefully considered. The Department must remember that schools operate differently and have differing informational and operational needs. As such, the interface of the new direct loan system must be designed to accommodate these differences or at least to allow adequate time for schools to adjust to new requirements.

Loan Origination. In spite of charges by some that institutions cannot properly perform loan origination functions, most of NASFAA's members have indicated that they can manage this task if it remains reasonable and is not unnecessarily encumbered with overly complex and burdensome requirements. Schools understand that under a direct loan program they will have additional responsibility and requirements for transmitting needed data to the Department and its contractors. However, promised institutional efficiencies will not be realized if financial aid administrators are required to input and transmit the equivalent of the current lender AND school sections of the Federal Stafford Loan application. Our members believe that only data essential to the making of the loan should be included; data needed by the Department of Education for research and analysis should be obtained through other means.

Again, I would simply note that information is unclear or lacking on this issue to the extent that 53 percent of NASFAA's survey respondents indicated that they had insufficient information to make a decision about originating loans.

Computer Support. The majority of NASFAA's survey respondents indicated that they have the basic computer equipment necessary for participation in the demonstration program. The larger unknown is whether the Department will be able to supply appropriate computer software. At least for purposes of the demonstration program, the Department planned to develop software to assist participating institutions in communicating with the Department. This is a critical need, and we presume that it would also be provided under any phase-in. As we mentioned earlier, it is essential that adequate planning and testing occur prior to implementation.

Precise and timely communication throughout the process is integral to the Department's ability to manage a direct loan program. Development and testing of computer software must include sufficient time to accommodate necessary modifications and ensure that problems can be resolved prior to system start-up. This testing is essential for a program of this magnitude and importance.

Several examples of the Department's attempts to initiate software programs come to mind.

Several years ago, the Department phased in an electronic application and reporting process for campus-based program funds (FISAP). This process was developed and refined over a number of years. Although it now works well, in the early years there were many problems that had to be worked out through time, testing, and numerous adjustments.

Also, beginning in the 1993-94 award year, the Department initiated EDExpress, a new integrated software package free to Electronic Data Exchange (EDE) participants. This was designed to enable participants to enter, report, and manage all EDE services

for Title IV student aid application information. Notwithstanding good intentions, I have been told by several colleagues that the software is not efficient and there have been numerous complications with it, including unfortunate service problems. Participants are having difficulty getting their phone calls returned from the Department's contractors or from the Department, and one upgrade has already had to be distributed to remedy some of the problems.

If the Department expects a direct loan program to operate efficiently, then the software it provides must be carefully developed and tested before it is sent out to large numbers of schools. If this is not done carefully, then major disruptions will occur.

Training and Support. Training is also a crucial to the success of any program of federal direct lending. Financial aid administrators must receive instruction on numerous aspects of the process, particularly (for loan-originating schools) those formerly performed by lenders or guarantors.

If many of the current loan requirements that are performed by lenders are transferred to schools then training on these requirements will be essential to insure school compliance. For example, numerous concerns have also been raised regarding the adverse credit history criterion for FPLUS borrowers. The proposed regulations on the demonstration program do not specify whose responsibility it is to obtain and evaluate a credit history; also, the term "adverse" is very narrowly defined.

Credit reports have not previously been in the purview of financial aid administrators. Financial aid administrators are not currently familiar with these tasks; it is not part of their routine to deny loans on the basis of information on credit reports or to explain which loans are delinquent. To ensure competence in the various ways to assess and score individuals' credit histories, the Department must provide precise training and support in this area. Guidelines on appropriate ways to communicate resulting decisions are also critical.

It is also essential that the Department receive adequate resources and time to thoroughly train its own personnel and associated contractors. The Department must familiarize the substantial number of new staff with an abundance of procedures as well as ensure that current staff continue to have adequate training support. If this requires separate directed appropriations, we believe it is incumbent upon the Department management to request such funds.

Reconciliation. Another area that will require specific and focused effort is reconciliation. Very little detail is available for this critical function area. This process has been described as an almost amazingly simple records-matching process, and we hope it will be. However, it will be at least partially a new process, both for

the Department and for participating schools, therefore, we believe that careful thought and school input is necessary to make it work.

Servicing and Collection Contracts. The Department must let contracts for servicing and collection of federal direct loans. The entities performing these services must be in place and operational when the program begins, but not later than six months from the time the first loan is made. It has been suggested by some that the Department has "more time" to develop and finalize these aspects of the program, because they will occur later in the process. This is not the case. It is entirely possible that a student may drop out soon after receiving an initial disbursement and begin repayment after the six month grace period has expired. Also, during that grace period, certain notifications are required to comply with due diligence requirements.

As such, we would strongly suggest that the Department be given maximum flexibility in selecting and contracting with servicers. Government procurement procedures are designed to insure competitive pricing, but pricing in and of itself is not necessarily the most important matter, when it comes to letting these contracts. Proven experience in servicing student loans and in performing collections must be very strongly factored into the letting of these contracts. Proven experience and familiarity with the student loan programs, in our opinion should receive more consideration than who submits the lowest bid. If the program is to work, then the Department needs the ability and the necessary resources to select the best contractors.

I also wish to mention that 58 percent of NASFAA survey respondents would prefer to select the servicer for their students. Schools have been held accountable for loan repayment outcomes, and therefore, they would like to be able to choose the servicer that best meets their students' needs.

NASFAA recognizes that this may not be practical given the structure of the new direct loan program. However, at a minimum, if a school finds that an assigned servicer is not measuring up to its requirements, or is otherwise dissatisfied, then the institution should be able to request that the Department transfer its students' records to another servicer.

Further, the Department should build in its system, a "customer-satisfaction" evaluation to insure on-going and regular assessment of the work and quality of service being provided by all of its contractors. Such an approach will help to maintain quality and responsive service that often begins to fade with long-term government contractors.

Transition. The Department must also continue its support for the Part B loan programs. Whatever the outcome of this budget reconciliation, the Part B programs will continue for the next several years, therefore, they must be supported and maintained so as not to jeopardize their viability and integrity.

In closing, let me make one final point. If a direct loan program is to be adopted and it appears that it will, then, we believe it to be essential that there be assurance of needed capital. While we understand the commitment that has been made to direct lending, mention has also been made of the possibility of entitlement caps on the program. Funding limitations of any sort are potentially problematic, however, it is important to distinguish how caps might affect the Part B program vs. a direct loan program. For the current Part B programs, an entitlement cap would limit the amount of loan subsidies; for a direct loan program, an entitlement cap would affect loan volume—two widely different levels.

Given the dependency of students and parents upon the existing federal student loan programs, it is essential that adequate levels of needed capital be maintained under either structure. While we understand the need for deficit reduction and program reform, they cannot occur at the expense of limiting or denying educational opportunity for our citizens.

Thank you for inviting me to appear before you. I would be happy to answer any questions you may have.

NASFAA Rapid Survey Network **1992-93 RSN Survey #3**

Direct Lending Issues **May 18, 1993**

Please indicate your response to each question in the space provided and return the completed survey within 48 hours via FAX #202-785-1487 (Attn: Fred Franko) or in the enclosed envelope. Thank you for your participation.

1. Given the structure and procedures outlined in the 4/2/93 Federal Direct Student Loan Program (Federal Direct Loan) Notice of Proposed Rulemaking (NPRM), which of the following best describes your school's current plans? (check one)

___ My school **will apply** to participate in the demonstration program.

___ My school is **considering** application to participate in the demonstration program.

___ My school **will not apply** to participate in the demonstration program.

___ We **do not have enough information** to make this decision at this time.

2. The 4/2/93 Federal Direct Loan NPRM stated that the following would be required for participation in the demonstration program: **A)** IBM compatible PC, 512 RAM, DOS version 3.3 or later, 4 MB space available on a hard disk, a floppy drive, and a 1200, 2400, or 9600 baud Hayes compatible asynchronous modem; or **B)** a mainframe computer supporting IBM 3780 RJE protocol and HASP using binary synchronous communications at 2400 and 4800 bits/second; and **C)** a printer that prints on 8-1/2 by 11 inch paper.

a. Do you have this equipment available for your use?

___ Yes ___ No

b. If no, can you acquire this equipment by July 1, 1994?

___ Yes ___ No

c. If no, can you acquire this equipment by July 1, 1995?

___ Yes ___ No

3. The Administration's direct loan proposal would permit institutions to originate loans or other entities to originate loans on behalf of eligible institutions. Given this option, if your school was selected for participation in a direct loan program, which of the following best describes your current plans regarding direct loan origination? (check one)

___ My school **would** originate loans.

___ My school **would not** originate loans.

___ We **do not have enough information** to make this decision at this time.

Note: for questions 4-6, please just provide your best estimates; there is no need to consult your records or perform any calculations.

4. Please estimate the approximate number of Federal Perkins Loans your school makes annually.

Number of Perkins Loans: _____

5. Please estimate the approximate number of FFELP (Federal Stafford, FSLS, and FPLUS) loans your school certifies annually.

Number of FFELP loans: _____

6. The Administration's direct loan proposal authorizes a loan origination fee averaging $10 per borrower per year for loan originators. Given your understanding of the administrative responsibilities of institutions as outlined in the 4/2/93 Federal Direct Loan NPRM, which of the following amounts most closely approximates the costs that your school would incur in originating a direct loan to a student? (check one)

___ Less than $5 ___ $5 to $10

___ $11 to $15 ___ $16 to $20

___ $21 to $25 ___ $26 to $30

___ More than $30

___ Insufficient information to estimate at this time

7. During any implementation or transition period, both the Federal Direct Loan Program and the FFEL programs would continue to operate. Under both the 4/2/93 Federal Direct Loan NPRM and the Administration's proposal, schools selected for participation in a direct loan program would no longer be allowed to make FFEL loans to their students. If the FFEL program is phased out as proposed by the Administration, which of the following options would you favor? (check one)

___ Schools should be limited to either a direct loan program **or** the FFEL program.

___ Schools should be allowed to participate in **both** programs until such time as the FFEL program is phased out.

(Please continue on side 2)

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8. If schools were allowed to participate in both programs at the same time, which of the following would you favor? (check one)

___ First year students be awarded Federal Direct Loans; all other students stay in FFELP.

___ New borrowers be awarded Federal Direct Loans; old borrowers stay in FFELP.

___ Undergraduate students be awarded Federal Direct Loans; graduate students stay in FFELP.

___ Schools are allowed to make this determination.

9. The Department of Education plans to issue a contract (or contracts) for servicing and collecting Federal Direct Loans. One goal is for each student to have only one servicer for all his/her loans. This may mean that schools will deal with more than one servicer. If possible, would you like to choose the servicer for your school, even if that choice may mean a servicer change for some transfer students?

___ Yes ___ No ___ Not sure

10. The following are some of the issues that have been raised relative to direct lending. Please indicate your school's reaction to these issues, using a scale of 1-5 where 1 = unconcerned, 2 = somewhat concerned, 3 = concerned, 4 = very concerned, and 5 = greatly concerned.

1 2 3 4 5 Timing of funds delivery to schools

1 2 3 4 5 Assurance of program funding

1 2 3 4 5 Schools' administrative ability to originate loans

1 2 3 4 5 Schools' administrative ability to disburse loans

1 2 3 4 5 Schools' administrative ability to reconcile loans

1 2 3 4 5 Schools' potential liability

1 2 3 4 5 Ability of ED to issue regulations in a timely manner

1 2 3 4 5 Ability of ED to provide training and support

1 2 3 4 5 Loan collections and servicing by ED contractor

1 2 3 4 5 Loss of services currently provided by lenders

11. Given all of the discussion surrounding direct lending, which of the following most accurately represents your feelings on this issue? (check one)

___ I would favor a phased-in direct lending program to replace FFELP.

___ I would favor a parallel direct lending demonstration program to evaluate its effectiveness before phasing out FFELP.

___ I would favor retaining the existing FFELP, but working to improve it and make it more cost effective.

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Mr. TOWNS. Mr. Butts.

STATEMENT OF THOMAS A. BUTTS, ASSOCIATE VICE PRESIDENT OF GOVERNMENT RELATIONS, UNIVERSITY OF MICHIGAN, ON BEHALF OF THE AMERICAN COUNCIL ON EDUCATION, AMERICAN ASSOCIATION OF STATE COLLEGES AND UNIVERSITIES, AMERICAN ASSOCIATION OF COMMUNITY COLLEGES, NATIONAL ASSOCIATION OF COLLEGE AND UNIVERSITY BUSINESS OFFICERS, AND NATIONAL ASSOCIATION OF STATE UNIVERSITIES AND LAND GRANT COLLEGES

Mr. BUTTS. Mr. Chairman and members of the subcommittee, I am pleased to have the opportunity to speak with you today on behalf of five national associations principally representing presidents of universities, including the American Council on Education, the National Association of State Colleges and Universities, the American Association of State Colleges and Universities, and the American Association of Community and Junior Colleges, as well as the National Association of College and University Business Officers.

I have served as a director of financial aid at the University of Michigan for a number of years. I was the Deputy Assistant Secretary in the Department of Education for part of the Carter administration. Most recently I have served as a member of the National Commission on Responsibilities for Financing Postsecondary Education. That Commission recommended moving to full direct lending.

Our associations would not support direct lending if we didn't think it was the best of the possible alternatives that are out there. We are keenly aware that the budget process this year requires $4.3 billion in savings in accordance with the way in which the budget rules have been written. And the choice between direct lending and taking $4.3 billion out of the current system is an easy one. Direct lending wins hands down.

We are very concerned about the possible disruption legislation that would take that amount of money out of the current system, would have on students and access to capital and everything else.

The students attending our institutions have too much at stake for direct lending to fail. We could not and would not support a complete change in the financing and delivery of loan programs if we didn't believe the Education Department was capable of meeting its management responsibilities.

The issue is not staffing at the Education Department. The issue is the structure of the student loan program. The best staff in the world can't administer a program that is structurally unsound as is the case with the guaranteed loan program. The GAO lists that program as a high-risk program.

You will note that it doesn't list the Perkins loan program as a high-risk program, the campus-based programs, or the Pell grant programs as high risk.

The Department has been able to manage those programs under very difficult circumstances over the last 12 years in a reasonable way.

Charles Kolb, the former Deputy Under Secretary of Education and Deputy Assistant for Policy for President Bush pointed out in a recent interview: "If the Department could not handle a less com-

plex direct loan program, how could it be expected to operate the current guaranteed system which is vastly more complicated?"

Dr. Lloyd Hackley at the recent Senate hearing on direct lending, who is the president of Fayetteville State University, stated: "This committee is on the threshold of an enormous opportunity to reform student aid, a reform that is long overdue. . . . The Department of Education is capable of administering direct lending." At the hearing, Marshal Witten from Vermont, a member of the Commission, made the same point.

The current student loan system includes the Education Department, but the Education Department is only one of the players. The existing system has so many players and the financial webs are so complex that accountability is simply not possible. Direct lending eliminates the middlemen and simplifies the program operation. Simplicity makes accountability possible.

We believe that direct lending will be easier and, as I said, a more accountable program with many of the existing servers and agencies working under contract to the Department. A major blow will be struck for simplicity and accountability.

Further, salary and expense money for direct lending is included in the legislation as a mandatory expense. It is there on the entitlement side of the budget. Pulling that money out so that the program can fail isn't possible as has been the case in recent years with the provision of necessary management money.

Mr. Joe McCormick, the former director of the Texas Guarantee Agency and a past president of NASFAA said recently in a letter: "The government has been in the direct student loan business since 1958 with what is now called the Perkins Loan Program, so there is nothing 'experimental' about the direct lending proposal."

Finally, the phase in. Nothing in 1993, 2 or 300 schools in 1994 and 1995; 25 percent of the volume in 1995; 1996, 60 percent, the following year; and then everybody.

Give me a break. That is a phasein program? That is a demonstration program in those years. This program can be fine tuned. The Department can run it, and it will be a far superior product than the current system.

Thank you very much. I will be happy to answer any questions.

Mr. TOWNS. Thank you, Mr. Butts.

[The prepared statement of Mr. Butts follows:]

STATEMENT OF

THOMAS A. BUTTS

BEFORE THE

COMMITTEE ON GOVERNMENT OPERATIONS

SUBCOMMITTEE ON HUMAN RESOURCES AND INTERGOVERNMENTAL RELATIONS

U.S. HOUSE OF REPRESENTATIVES

"MANAGING THE FEDERAL DIRECT STUDENT LOAN PROGRAM"

JUNE 10, 1993

ON BEHALF OF THE

AMERICAN COUNCIL ON EDUCATION

AMERICAN ASSOCIATION OF STATE COLLEGES AND UNIVERSITIES

AMERICAN ASSOCIATION OF COMMUNITY COLLEGES

NATIONAL ASSOCIATION OF COLLEGE AND UNIVERSITY BUSINESS OFFICERS

NATIONAL ASSOCIATION OF STATE UNIVERSITIES AND LAND GRANT COLLEGES

Mr. Chairman and Members of the Subcommittee, I am Thomas A. Butts, Associate Vice President for Government Relations at the University of Michigan. I am pleased to have the opportunity to appear before you today on behalf of five national higher education associations to discuss the management of the Federal Direct Student Loan Program.

By way of background, I was the Director of Financial Aid at the University of Michigan from 1971-77. From 1977-81, I served in the U.S. Office of Education and later the Education Department as a policy advisor on student aid and for two years as the Deputy Assistant Secretary for Student Financial Assistance. Most recently, I have served as a member of the bipartisan National Commission of Responsibilities for Financing Postsecondary Education (NCRFPE). The Commission's report, Making College Affordable Again, was released last February and has received considerable attention.

After substantial discussion and analysis, the associations I speak for today support the Administration's phase-in plan for direct lending. None of the alternatives under discussion compares favorably with direct lending. We are pleased with the improvements made by the House when direct lending was included as part of the budget reconciliation bill. Central to our support is the assumption that the Education Department can and will be able to fulfill its management responsibilities for the program.

We are keenly aware that the budget process this year requires savings of $4.3 billion over the next five years from the student loan programs. While there has been much attention on the Education Department's ability to manage direct loans, little attention has been given to the sudden administrative burden that will be forced upon the department if alternatives are enacted. Alternative proposals to generate $4.3 billion in savings would also impose a substantial burden on the Department of Education. Indeed, the burden may be higher than direct lending because the effective date for these proposals is usually much sooner than for direct lending. We are very concerned about the possible disruption legislation of this sort may cause. Given the choice between the two alternatives, we believe the direct loan option is the better.

We would not put $18 billion of loan capital for our students at risk if we did not believe that the problems with the current loan guarantee system are so pervasive that fundamental change is required. We could only support a replacement program that we believe would work for all institutions. We believe that the simplified delivery system options available to institutions contained in the House passed bill will make it possible for small and large institutions to participate in direct lending in a cost effective way.

The students attending our institutions have too much at stake for direct lending to fail. We could not and would not support a complete change in the financing and delivery of the loan programs if we did not believe that the Education Department was capable of meeting its management responsibilities. The issue is not staffing at the Education Department; the issue is the structure of the student loan program. The best staff in the world can't administer a program that is structurally unsound.

It is important to note that the House Education and Labor Committee was prepared to approve a full direct lending program in the House reauthorization of the Higher Education Act last year. It was only after a threatened veto by the previous administration the House agreed to a demonstration program. Indeed, a number of key former members of the Bush Administration support the Clinton Administration plan for direct lending. A copy of their letter of support is attached to my statement.

Charles Kolb, former Deputy Undersecretary of Education and Deputy Assistant to the President for Domestic Policy for President Bush, pointed out in a recent interview in Department of Education Reports: "...if the Department could not handle a less-complex direct loan program, how could it be expected to operate the current guarantee loan system, which is 'vastly more complicated'."

Dr. Lloyd V. Hackley, Chancellor, Fayetteville State University, in testimony before the May 26, 1993, Senate Labor and Human Resources Committee on behalf of the Office for the Advancement of Public Black Colleges, NASULGC and AASCU stated: "This Committee is on the threshold of an enormous opportunity to reform student aid -- a reform that is long overdue... The Department of Education is capable of administering direct lending." A copy of Dr. Hackley's statement is attached.

At the same hearing, NCRFPE member R. Marshal Witten, a trustee of the Vermont State Colleges, pointed out that "...In the face of fiscal realities, direct lending provides a unique opportunity to simplify the entire student aid system..." One of the Commission's major recommendations was to replace guaranteed loans with direct lending.

The current student loan system includes the Education Department but the Department is only one of many players. The existing system has so many players and the financial webs are so complex that accountability is not possible. Direct lending eliminates "middlemen" and simplifies program operation. Simplicity makes accountability possible.

The Education Department is responsible for the management of the current program of loan guarantees yet its hands are, for all practical purposes, tied, when it comes to having the authority and resources to manage the program. The 7,800 lenders, 44 guarantee agencies and 35 or so secondary markets don't work for ED. Any and all of the players complain to the Congress at the slightest call for coordination, common data systems and accountability. For many years, current participants in the loan program blocked any efforts to improve the delivery of services under the program. For example, each of the guarantee agencies has always insisted on having its own application to participate in the federal student loan program. This means there are 46 separate applications, all requesting slightly different applications. This greatly complicates the administrative burden facing schools.

In addition to a common application --- which will soon become a reality thanks to an act of Congress --- there are plenty of other examples. A single lender claim form, student confirmation report and a rational data base of student borrowers have all been blocked because current participants in the loan program did not want them.

We believe that direct lending will be an easier, more accountable program. With many of the existing servicers and agencies working under contract to the department, a major blow will be struck for simplicity and accountability. Further, the inclusion of salary and expense funding in the legislation as a mandatory expenditure will ensure that the resources necessary for management will be available when needed.

Mr. Chairman, I believe that Joe L. McCormick, a former CEO of the Texas Guarantee Agency and past president of the National Association of Student Financial Aid Administrators, summed it up well in a May 25, 1993 letter to Senator Paul Simon:

> The Federal government has been in the direct student loan business since 1958 with what is now called the Perkins Loan Program, so there is nothing "experimental" about the direct lending proposal. I agree that the Department of Education cannot administer a complex, multi-layered loan program made up of 7,800 lenders, 35 state secondary markets plus Sallie Mae, and 44 guarantee agencies. However, ED can administer a direct loan program that uses schools to originate the loans and contracts with the private sector to service those loans, thus greatly reducing the administrative burden of the Department of Education. A direct loan program that is fully integrated with the existing federal student aid delivery system offers the greatest opportunity in over thirty years to simplify and streamline the student loan process.

Mr. Chairman, I have read the report on the Senate Permanent Committee on Investigations (Nunn) hearings on the loan programs and sat through most of them. I have read the GAO reports and observed what has happened to the Education Department over the past 12 years. I might say that it was with some personal pain that I watched the career service carry out its responsibilities for the student aid programs with leadership that was unable or unwilling to command the resources necessary to do a proper job.

I am impressed that the programs, with all of their documented problems, continued to operate as well as they did during that period. It has been clear that the guaranteed loan program was destined for trouble in the best of circumstances because of its structure. However, the Pell Grant and campus-based programs (including Perkins) have continued to work well.

We have been impressed with the leadership Secretary Riley and Deputy Secretary Kunin have brought to the department. They are committed to making things work right. I have had the opportunity watch the plans for direct lending develop and believe that it will work. I am confident that, with the authority to manage the

transition contained in the House passed legislation, the switchover will proceed satisfactorily and loan capital will continue to be available to students during the phase-in period.

The time allocated for the direct loan phase-in is reasonable. Roughly 250 out of more than 7,000 institutions will participate in the 1994-95 school year. It will grow to an estimated 25% of the loan volume in 1995-96, 60% in 1996-97 and not until 1997-98 will everyone participate. Obviously, there will be time to fine-tune things along the way and the bill gives the Secretary of Education specific authority to slow down this schedule if necessary. This is hardly a plan to rush headlong into direct lending.

Finally, Mr. Chairman, we believe that direct lending will provide better service and benefits to students, will be easier for institutions to manage than the current system and will be a better deal for taxpayers.

Thank you for your consideration of our views. I would be happy to answer any questions you might have.

Charles Kolb
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Alexandria, VA 22314
(703) 836-6199

May 25, 1993

Honorable Edward M. Kennedy
Chair, Senate Labor and Human Resources Committee
Senate Russell Office Building
Room SR-315
Washington, D.C. 20510

Honorable Nancy Kassebaum
Ranking Minority Member, Senate Labor and Human Resources Committee
Dirksen Senate Office Building
Room SD-428
Washington, D.C. 20510

Honorable William Ford
Chair, House Education and Labor Committee
Rayburn House Office Building, Room 2107
Washington, D.C. 20515

Honorable William Goodling
Ranking Minority Member, House Education and Labor Committee
Rayburn House Office Building, Room 2181
Washington, D.C. 20515

Dear Members of Congress:

As Republicans who served under Presidents Ronald Reagan or George Bush, we believe that the time has come to restructure the federal guaranteed student loan ("GSL") program -- a program that has become overly complex, lacks accountability, and wastes taxpayers' dollars through needlessly high loan default rates.

We are writing to express our support for reforming the GSL program by replacing the existing system with a new direct loan program.

According to estimates prepared by the Department of Education (under both Presidents Bush and Clinton), the Congressional Budget Office, and the General Accounting Office, the new direct loan program will also result in significant annual budget savings that could be used for deficit reduction. Direct borrowing by the federal government to capitalize the direct loan program as a revolving fund will save on the current interest and special allowance subsidies now paid to banks and others while

ensuring a more streamlined, efficient, and workable program that meets the needs of America's students. As such, a direct loan program offers a more cost-effective delivery system for providing student financial assistance.

Over the years, the guaranteed student loan program has developed a degree of regulatory and administrative complexity that now undermines its fundamental integrity and effectiveness. Replacing the GSL structure with a streamlined structure will mean not only enhanced accountability and budget savings, but also a more rational delivery system that will particularly benefit students and educational institutions. In particular, we believe direct loans will also ensure greater responsibility and accountability by participating educational institutions.

A direct loan program will mean replacing the role currently played by many banks, guarantee agencies, and secondary markets with a much more competitive approach. The intent is not to harm these participants in the existing program but rather to recognize that more competitive, efficient, and practical ways exist to provide student loans. We hope that as the Congress considers direct loans it will look beyond the misleading information that is being spread by representatives of those entities who have a direct financial stake in preserving the status quo.

We believe that the Clinton administration has taken the correct position on this issue and urge the Congress to consider this much-needed reform of the student loan program. In fact, much of the initial work that led to the direct loan program currently under consideration was undertaken during the Bush administration. While a valuable direct loan pilot program was authorized last year, we regret that this work was not pursued more seriously and vigorously during last year's reauthorization of the Higher Education Act. Nonetheless, we hope that the Congress will act in a true bipartisan fashion to approve direct loans in order to bring sweeping and needed reform to the student aid delivery system.

Should bipartisanship not be possible, we call upon our fellow Republicans to unite behind the direct loan proposal and to show leadership in this and other efforts to reform government. We favor reforms that will ensure real value for the taxpayers' dollar, with government activity targeted to ensure more effective efforts delivered in ways that are accountable to the American people.

Sincerely yours,

Rich Bond
Former Chairman, Republican
National Committee

Diana Culp Bork
Former Deputy General Counsel
U.S. Department of Education

James P. Pinkerton
Former Deputy Assistant to the
President for Policy Planning

Carolynn Reid-Wallace
Former Assistant Secretary for
Postsecondary Education
U.S. Department of Education

Nancy Mohr Kennedy
Former Assistant Secretary
for Legislation and Congressional Affairs
U.S. Department of Education

Michael J. Horowitz
Former General Counsel
Office of Management and Budget

Charles E.M. Kolb
Former Deputy Assistant to the
President for Domestic Policy

George A. Pieler
Former Acting Deputy Under Secretary
for Planning, Budget and Evaluation
U.S. Department of Education

cc: Senate Committee on Labor and Human Resources
Committee on Education and Labor

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TESTIMONY

OF

DR. LLOYD V. HACKLEY, CHANCELLOR

FAYETTEVILLE STATE UNIVERSITY

TESTIFYING ON BEHALF OF THE

OFFICE FOR THE ADVANCEMENT

OF PUBLIC BLACK COLLEGES (OAPBC)

NATIONAL ASSOCIATION OF STATE UNIVERSITIES

AND LAND-GRANT COLLEGES (NASULGC)

AND THE

AMERICAN ASSOCIATION OF STATE COLLEGES

AND UNIVERSITIES (AASCU)

BEFORE THE

COMMITTEE ON LABOR AND HUMAN RESOURCES

MAY 26, 1993

Mr. Chairman, members of this distinguished Committee, I am Lloyd Hackley, Chancellor, Fayetteville State University. I am pleased to have the opportunity to testify on behalf of the Office for the Advancement of Public Black Colleges (OAPBC), the National Association of State Universities and Land-Grant Colleges (NASULGC) and the American Association of State Colleges and Universities (AASCU). These two associations represent over 5.6 million students and constitute the largest volume of student loans and other forms of student financial assistance in the nation. America's state-assisted institutions of higher education are bound by a democratic philosophy that is envied and respected worldwide--a philosophy that boldly asserts that men and women of talent and ability, regardless of their economic and social condition, can achieve the "American Dream" with hard work and a helping hand from higher education and the nation.

These institutions serve an enormous range of students in terms of economic, social and ethnic background. They are students from wealthy and welfare families. They come from rural communities in Lorman, Mississippi, ravished neighborhoods in East St. Louis and the urban populous of Los Angeles, California. They are from blue-collar, white-collar, and no-collar families--but they all come to the "people's universities" believing in the power of education to make a difference in their social and economic condition.

Today, American higher education is challenged as never before to bring academic and nonacademic functions closer together while improving our nation's ability to become more responsive to the educational, social and economic imperatives of a highly diverse student body. At a time when the nation is coming face-to-face with the dire consequences of massive human casualties in a $6 trillion economy, our institutions are looking for new ways to be more

productive, more competitive, more fiscally-conscious and at the same time more responsive to human needs for the common good of the state and the nation. Sharing a sense of responsibility for revitalizing our national economy, we in higher education are doing a better job of clarifying our missions and redefining our priorities while contributing to the larger national goal of restraining rising costs.

The higher education community is committed to providing insight, vision and leadership in moving forward to implement the Student Loan Reform Act. We can speak with pride about the willingness and the capacity of our institutions to use this extraordinary opportunity to better serve our students. As Chancellor of Fayetteville State University, I commend the Committee for engaging the higher education community in helping to shape the Student Loan Reform Act. As instruments of the state and the

nation, public colleges and universities should be front and center in reforming federal student aid programs, thus, insuring that direct lending is designed to serve the interest of our students and at the same time the national interest of our economy.

Mr. Chairman, we believe the President's proposal satisfies the essential criteria for a simplified, efficient direct loan program with tremendous savings for students, institutions of higher education and the nation. We have long advocated a system of student loans that is user-friendly, easily accessible, and fiscally responsible. As stated in a recent article by Thomas Butts and Elizabeth Hicks, "Direct lending offers the best of both centralization and decentralization...it eliminates the current system's confusing negotiations between the borrower and the university...funds go directly to students' billing accounts without compromising standards of integrity and accountability." This Committee is on the

threshold of an enormous opportunity to reform student aid--a reform that is long overdue.

The Department of Education is capable of administering direct lending. Educational institutions possess the efficiency, technical expertise, staffing, administration, physical plant, instrumentation and fiscal management capacity to meet this challenge. Our institutions have managed Work-study, Perkins and its predecessor, the National Defense Student Loan (NDSL), Supplemental Grants, and campus-based financial aid programs. The General Accounting Office found that the current system is "unauditable and not conducive to good financial management...and that a direct loan program would be easier to manage and greatly reduce the opportunities for error and abuse." The radical simplification that would ensue under direct lending would allow for better oversight and accountability and turn the current polygon--that includes the

Department of Education, the school, the student, the lender, the guarantee agency, the secondary market, the servicer, the collector, and the Internal Revenue Service--into a triangular relationship that is more effective, sensible and integrated in the management and delivery of services--with the Department, the school, and the student in control.

From where I sit at a small, under-funded university in Fayetteville, North Carolina, I strongly believe that direct lending is in the best interest of the most important consumers--14 million students in the nation's colleges and universities.

From the public college perspective, the direct lending program has many key advantages:

- It will make loan capital available to all students.

- It will assure availability of loans to all students during the transition period to full direct lending.

- It will better serve students and parents by making the process of getting and repaying loans easier to understand.

- It will generate considerable savings which can be used to provide additional funding in the future for other federal student aid programs and reduce the national deficit.

- It will provide institutions of higher education with the option of originating loans. No institution will be

required to originate loans. Institutions will receive a small administrative fee established by the Secretary of Education.

- It will provide borrowers with various repayment options including income contingent repayment and borrowers are allowed to change their choice of repayment options.

There is no question about our support for this bill. Understandably, in legislation this complex, inevitably there are items that require perfecting. For example, the proposed 6.5 percent origination fee exacts too much from students and should be reduced below 5 percent or eliminated.

There have been those, even in the higher education community, who have expressed concern with parts of the legislation. Serving

at a small historically black public university, we are willing and ready to take on this new opportunity. The higher education community must get busy preparing to meet the challenge, to smooth the way for our students and to take on some short-term adjustments and problems for long-term advancements and profit.

It is clear that sacrifices are required by all of us as we struggle with the overwhelming national debt. The higher education community is prepared to contribute to that effort. The $4.2 billion savings in the lending program contained in the budget resolution, if simply taken as a cut in student aid programs, would be devastating. Reducing the deficit is the wellspring of a more vibrant economy, a better standard of living, and ultimately, increased federal resources for our students. The Student Loan Reform Act protects our students, while contributing to the national interest.

At the same time, we recognize that some of our smaller black colleges are concerned about any additional administrative responsibilities. The Act provides assistance for administrative costs and allows schools that do not wish to originate loans other alternatives. The higher education community will be prepared to address these and other concerns peculiar to small and limited-resource institutions in negotiated rulemaking with the Department of Education.

However, there is a major concern that must be addressed in the legislative process in all Title IV programs. In the Act, institutions with default rates of 25 percent or more in at least one of the two most recent years for which default rates have been calculated will not be allowed to originate loans. As you know, HBCU's enroll a disproportionate share of low-income students who bring to our

campuses all the inequities of our larger society. Thus, 1988-1990 data show that of 40 public black colleges 10 have an average default rate greater than 25 percent and 22 reported increases in 1990 compared to 1988. This alarming trend compels the Congress to extend the current law exemption for black colleges through 1997 or permanently exempt institutions that serve disproportionate numbers of low-income students and have low-volume defaults in terms of aggregate dollars.

The unique needs and circumstances of black colleges must be thoroughly examined given our commitment to serve growing numbers of dependent and impoverished students who find equality of opportunity profoundly difficult to obtain. With substantially limited resources, few political options and marginal state support, black colleges continue to face competing fiscal priorities while

maintaining the integrity of federal financial aid programs. More than 50 percent of the 4,000 students on my campus come from families with incomes of less than $20,000 annually and over 50 percent receive some form of financial assistance. Our loan volume in 1992-93 was over $1.4 million. In 1988 we had a default rate of 13 percent and in 1990 the rate increased to 14 percent. At a number of black colleges more than 75 percent of the entire student body receives financial assistance.

Given the realities of the economy compounded by the realities of inequality:

- We can't ignore the fact that between 1972 and 1990, median family income rose 8 percent compared with 89 percent between 1950 and 1970.

- We can't ignore the fact that the richest fifth of American families control about 43.7 percent of all income while 33 million people, with a disproportionate number being black Americans, remain locked in the wicked cycle of poverty.

- We can't ignore the fact that far too many low-income students are forced to make loans in the absence of state and federal grants.

The condition of black America is a major indictment of our nation's unwillingness to come to grips with the pervasive economic problems that are crippling the ability of our children to have valid reasons to hope and to prosper. If the nation's black colleges are to pave the way for future generations, we must use this opportunity to redefine and restructure federal student financial aid programs for

ALL colleges and universities and particularly those confronted with a host of social and economic barriers. Given the role of IRS and the simplicity of the program, direct lending may be the first step toward reducing defaults at black colleges.

As noted in Let's Take Back Student Aid: Direct Lending Issues and Myths, authored by G. Kay Jacks and Jerry Sullivan, financial aid directors at Colorado State University and the University of Colorado respectively, "We must remember why we have student loans...educational credit is first and foremost to make higher education a reality for those who cannot afford it. It is a social program, intended to promote society's goals through education. Any discussion about a change in federal policy must be measured using students as the touchstone. Direct lending has been referred to "...as a Pell Grant with a promissory note. Others have called it a Perkins without a funding cap with no responsibility to service

and collect loans...It allows institutions to focus on the individual students, not the unpredictable characteristics of an unexplainable loan program." By the way, copies of Let's Take Back Student Aid:... were sent to every U.S. Senator.

I say it is time to reverse the skepticism about direct lending and turn it into a national priority, a commitment, a mandate that propels out institutions into the 21st Century, providing the full range of financial assistance to our students while making a deep and sustained difference in advancing equality of opportunity for all.

Direct lending--

(1) Streamlines and simplifies the loan process.

(2) Lowers the net cost to students and to the federal government.

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(3) May reduce default rates and provides better repayment terms with income-contingent arrangements.

(4) Eliminates the existing profit-driven incentive structure and places student loan programs where they should be--in the hands and hearts of the higher education community.

For these reasons--it is the right time and the right thing to do for all the right reasons--and these reasons are students, students, students.

I sincerely appreciate this opportunity to testify before this august body on behalf of 35 historically black public colleges and universities and nearly 600 state and land-grant universities in the nation.

Mr. TOWNS. Dr. Forbes.

STATEMENT OF ORCILIA ZÚÑIGA FORBES, Ph.D., VICE PRESIDENT FOR STUDENT AFFAIRS, UNIVERSITY OF NEW MEXICO

Dr. FORBES. I would like to acknowledge Representative Schiff who is our Representative, our institution is in his district.

I am Orcilia Zúñiga Forbes, vice president for student affairs at the University of New Mexico. I am honored to appear before you this morning to testify on behalf of the University of New Mexico in support of the proposed Federal direct student loan initiative.

Prior to coming to the University of New Mexico, I might add, I was at Portland State University in Oregon. So I have had almost 30 years of experience in higher education, and 15 of those are in direct supervision of financial aid operations.

We have followed the developments of Federal direct lending both in the Department of Education and in the Congress. We have determined that the direct lending program is in the best interest of the University of New Mexico, New Mexico, and the Nation. We do not see significant problems with the existing language and, therefore, endorse the bill. We are prepared to administer the program as a service to students.

New Mexico has a diversity of institutions. Therefore, it is very important—and we appreciate the flexibility that would be built into that program—to give institutions a choice as to whether they want to originate loans. We can foresee that there will be some in New Mexico who may not wish to originate them.

We also believe that it is important for the institutions to receive the part that is suggested for cost of administration. The university has a diverse student population of 25,000 students on our main campus, and we have an additional 5,000 in three branches. Our financial aid office administers, on behalf of 13,500 students, approximately $60 million in funding from Federal, State, and institutional sources.

We have developed the personnel and other resources to provide the best service to students and accountability to the Federal, State, and university officials who monitor all of the programs.

I will add that coordination between UNM and the Department of Education has been excellent. We have taken advantage of all opportunities to automate the transfer of information between the Department and our university. So our experience leads us to expect that the Department will be prepared to implement direct lending through a phased program, either directly or by contracting out portions of the process.

And I speak about contracting out because in New Mexico, the New Mexico Educational Assistance Corp. serves in collections. We also give them a contract to collect tuition and other past due bills. So we have a good system for collection.

I will not repeat any of the advantages that have been listed for students, among them the simplification for the institutions who are able and feel competent in handling the program. We believe the Department, through working with fewer organizations and agencies, again, will be better equipped to handle the existing and the proposed program.

In summary, we at the university look forward to participating in the Federal direct student lending program and expect that the Department will provide the leadership under congressional direction for a successful program.

Thank you, and I am prepared to respond to questions.

Mr. TOWNS. Thank you very much Dr. Forbes.

[The prepared statement of Dr. Forbes follows:]

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TESTIMONY

to the

HUMAN RESOURCES/INTERGOVERNMENTAL RELATIONS SUBCOMMITTEE

Orcilia Zúñiga Forbes, PhD
Vice President for Student Affairs

THE UNIVERSITY OF NEW MEXICO

Mr. Chairman, members of the Committee, I am Orcilia Zuniga Forbes, Vice President for Student Affairs at The University of New Mexico. I am honored to appeared before you this morning to testify on behalf of The University of New Mexico in support of the proposed Federal Direct Student Loan initiative.

After following the developments on Federal Direct Student Lending in the Department of Education and Congress, The University of New Mexico has determined that direct lending is in the best interest of UNM, New Mexico, and the Nation. We do not see significant problems with the existing language of the Act. We therefore endorse the bill, and we are prepared to administer the program as a service to students.

New Mexico has a diversity of institutions, therefore we appreciate the flexibility that would be built into the program to give institutions a choice in whether they wish to originate loans. We also believe that it is important to maintain the fee that institutions would receive as part of the cost of administration.

The University of New Mexico has a diverse student population of 25,000 on main campus and an additional 5,000 in three branches. Our student Financial Aid Office administers on behalf of 13,500 students, approximately 60 million dollars in funding from federal, state and institutional sources. We have developed the personnel and other resources to provide the best service to students and accountability to the federal, state and university officials who monitor all of the programs.

Both our staff and computer capabilities reflect the most professional up to date operation. Our resources are adequate to expand to direct lending in the Stafford program. We definitely plan to apply to participate early in the program should this act become law.

Coordination between UNM and the Department of Education has been excellent. We have taken advantage of all opportunities to automate the transfer of information between the Department and the University. Our experience, leads us to expect that the Department will be prepared to implement direct lending through a phase in strategy either directly or by contracting out portions of the process.

From an institutional perspective, the advantages in direct lending are:

Advantages to Students

- Simplifies the application process for students and families.
- Provides for timely access to loan funds by students.
- Provides for more flexible repayment options.
- Provides for long term access to funds.

Advantages to Institutions

- Simplifies the student loan application process for institutions through the elimination of a separate application.
- Data and funds more conducive to electronic transmission.
- Simplifies the reporting process for institutions.
- Substantially reduces the labor intensive tasks related to processing of individual's applications.
- Provides for administrative options in loan origination function.

The Department of Education is most competent to administer this program. Direct lending appears to provide a more manageable process of student loans for the Department of Education. The program reduces to a select group the agencies with whom the Department of Education works. There will also be better utilization of their existing data and financial systems.

In summary, we at the University of New Mexico, look forward to participating in the Federal Direct Student Lending program and expect that the Department of Education will provide the leadership under Congressional direction for a successful program.

Mr. TOWNS. Ms. Bloomingdale.

STATEMENT OF STEPHANIE BLOOMINGDALE, ON BEHALF OF U.S. STUDENTS ASSOCIATION

Ms. BLOOMINGDALE. Thank you. I would like to thank the subcommittee for giving us this opportunity to testify.

I am a recent graduate of the University of Wisconsin, Milwaukee, and am here on behalf of the U.S. Student Association.

The availability of student loans have given many citizens, including myself, the opportunity to better themselves and in turn to better their society. If I had not received student loans, I can safely say that I would not be sitting here today.

After high school, when I was making the decision of whether or not to pursue a college education, I was unsure that myself or my mother would be able to afford it. Fortunately, my mother was familiar with the financial aid process as she had recently returned to school to finish her nursing degree. She was not only there to explain the process but helped navigate me through the arduous task of applying for financial aid.

I might add that had I known that the tuition at the University of Wisconsin Milwaukee would more than double during my tenure and I would be saddled with $18,000 in debt upon graduation, I don't know if I would have chosen college at that time. But I did get a college degree; I do have loans; and I am here to speak with you today about the role of the Department of Education in providing loans to students.

Students experience many difficulties with the current system, both when taking on a loan and when in repayment. With campus-based aid and with Pell grants, a student only needs to deal with their financial aid office.

With loans, a student must deal with a bank and a guarantee agency. Even when the financial aid office deals with these other entities, students often experience delays and mistakes as a result of this complex process. While I was in college a common problem I faced was the delayed disbursement of my loan check. My Pell grant and campus-based aid was always on time. However, it was not enough to cover the cost of my tuition. Therefore, I often incurred late fees and penalties while I waited for the loan check to arrive.

Students in repayment face similar problems due to the complexity of the current system. Often individuals are not informed of their options for repayment. Students are sometimes even misinformed about their obligations. For example, many students call us at the office who have been incorrectly told that they cannot consolidate their loans.

And individuals often do not know who owns their loans or where to send the payments. These mistakes often result in unnecessary defaults due to misinformation rather than an unwillingness of the student to pay back his or her loans. These mistakes can destroy students' credit ratings and their futures.

Because of the problems with the current system, I strongly support direct lending. The Federal Government has shown that it can adequately disburse other forms of financial aid such as Pell grants and campus-based aid. Direct lending will allow the Department of

Education to exert more direct control over all the entities in the system.

Financial aid administrators will either directly give out loans or will only deal with one alternative originator as opposed to a multitude of entities.

I recognize that the Department has faced many problems during the past 12 years, primarily due to neglect from the Department's leadership and past administrations. However, the new Department of Education, under Secretary Riley seems to have been reinvigorated and is ready to face the challenges that direct lending poses.

However, to ensure that direct lending will meet the needs of students, I feel that there are a number of areas that the Department does need to address.

First of all, the Department must go through some form of public consultative rulemaking with the higher education community and students so that the implementation of the program is problem free. The direct lending legislation that the House passed would allow for the Department to impose these regulations without a formal consultation process. If there is not enough time for a full rulemaking process, it is necessary that the Department create a mechanism for formal consultation with all affected groups.

Second, students should not be forced to deal with confusion and delays when taking out their loan. When schools choose alternative originators, the Department should ensure that the financial aid office is familiar with a clear process for remedying mistakes. This requires training and information.

Additionally, the speed and the quality of service should be a criterion in the selection of alternative originators. Students should understand the rules and the regulations of the process, and they should also know that they can appeal anything. Too many students see the institution as impenetrable and, therefore, give up on applying for financial aid and, thus, oftentimes, their futures.

Third, the Department of Education must take on the task of providing easily understood information to students and must strictly enforce its own rules.

The Department currently has a 1–800 phone number, but many students don't know it exists. The phone line is understaffed; and even when the Department takes the side of the student, they do not directly intervene. The Department should publicly advertise how borrowers can contact them and must create a student services department that would field the calls in a manner that conveys that the Department is interested in individual student's problems. The Department must also utilize its power to directly intervene when a student faces a problem with a collection agency.

Fourth, the students must be informed of the terms of the repayment options. I know provisions under the 1992 amendments to the Higher Education Act now require lenders and guarantee agencies to inform borrowers of their repayment options beginning in July 1993. I am happy that there is some language to this effect in the Student Loan Reform Act of 1993. But I feel it needs to be strengthened.

I understand that under the Student Loan Reform Act, students will have multiple repayment options, including income contingent

loans. This type of loan payback would help someone like me who worked for a nonprofit organization that is not very well-paying. And I know other students who also want to work for nonprofit organizations or as teachers or other community sensitive jobs but they cannot because of their massive debt that they incurred while in college and they would also be interested in this type of repayment. These students would benefit from this program. Yet those that choose this option must be informed that they will face a longer repayment period and will be forced to pay back much more interest than they would under standard repayment.

I would like to see regulations requiring the Secretary to inform borrowers of the amortization schedule, length of repayment, amount of interest, and total amount to be repaid for each repayment option. Additionally, language given for contingent repayment must include such information for a range of income levels.

And the Department must strictly enforce its regulations and allow only those with exemplary service to originate and collect student loans. Often, today, students and other entities do not abide by the Department's rules and regulations. For example, currently, schools are supposed to give every student an exit interview. I not only never received such an interview, I had never even heard of one until just recently. Under a system of direct lending, the institutions must provide a comprehensive exit interview so that the student is informed of its responsibilities, rights, and repayment options.

In all steps of the process, students should have an institutionalized role in judging the quality of service of those involved with the student loans, and the Department should deny contracts to those entities who violate its regulation.

I would like to thank you very much for allowing me to testify today.

Thank you.

[The prepared statement of Ms. Bloomingdale follows:]

"Organizing and Advocating for Students Across the Country"

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Testimony of Stephanie Bloomingdale
University of Wisconsin - Milwaukee

Representing the United States Student Association

Before the House Subcommittee on Human Resources and Intergovernmental Relations
June 10, 1993

My name is Stephanie Bloomingdale, I am a recent graduate of the University of Wisconsin — Milwaukee, and I would like to thank the Committee for giving me this opportunity to testify.

The availability of student loans has given many citizens, including myself, the opportunity to better themselves and in turn, to better their community and their society. If I had not received student loans, I can safely say that I would not be sitting here speaking with you today. After high school, when I was making the decision of whether or not to pursue a college education, I was unsure that myself and my mother would be able to afford it. Fortunately, my mother was familiar with the financial aid process as she had recently returned to school to finish her nursing degree. She was not only there to explain the process to me, but she also helped navigate me through the arduous task of applying for financial aid. Not everyone is fortunate enough to have a parent who is familiar with financial aid. These young people must depend upon high school guidance counselors who are often overworked and misinformed about the subtle nuances of financial aid.

I also might add, that had I known that tuition at the University of Milwaukee Wisconsin would more than double during my tenure and that I would be saddled with more than $18,000 in loans upon graduation I don't know if I would have chosen college. But, because of all these "ifs" I did get a college degree, I do have loans, and I am here today to talk to you about the role of the Department of Education in providing loans to students. I am also speaking on behalf of the United States Student Association, which represents 3.5 million students at over 350 colleges and universities throughout the country.

Students experience many difficulties in the current system, both when taking out a loan and when in repayment. With campus-based aid and with Pell Grants, a student only needs to deal with their financial aid office. With loans, a student must deal also with a bank and a guarantee agency. Even when the financial aid office deals with these other entities, students often experience delays and mistakes as a result of this complex process. While I was in college a common problem I faced was the delayed disbursement of my loan check. My Pell Grant and campus-based aid was always on time, however, it was not enough to cover the cost of my tuition, therefore I often incurred late fees and penalties while I waited for my loan check to arrive. At the United States Student Association, we receive many complaints about such delays. For example, one student from Iowa testified before the Senate last week that every semester he must contact his lender and explain that he is enrolled and does not need to begin repayment on his SLS loan before he can receive any of his other student loans. This process generally takes months because he must repeatedly contact his lender before the situation is corrected. Because he is the father of three children, this causes his family many difficulties.

Students in repayment face similar problems due to the complexity of the current system. Often individuals are not informed of their options for repayment, students are sometimes misinformed about options (for example, many students call us who have been incorrectly told they cannot consolidate their loans) and individuals often do not know who owns their loan or where to send payments. These mistakes often result in unnecessary defaults due to misinformation rather than an unwillingness to pay — these mistakes destroy students' credit records and their futures. I have experienced a lack of information regarding the loan process. For example, after I left college I went to work for the United States Student Association which is a very rewarding and challenging job, however I am only paid $15,000 a year. After 6 months I had to make monthly loan repayments of $200, of which over $100 dollars is in interest alone! During this time I was very concerned about my ability to repay my loans, buy food, pay rent and basically live in Washington, DC. Until recently, I was not aware that it was possible for me negotiate the terms of my repayment with my lender. If my lender had furnished this information to me upon my graduation from college, I would have saved many months of undue stress and worry.

Because of the problems with the current system, I strongly support Direct Lending. The federal government has shown it can adequately disburse other forms of financial aid such as Pell Grants and campus based aid. Direct Lending will allow the Department of Education to exert more direct

control over all the entities in the system. Financial aid administrators will either directly give out loans or will only deal with one alternate originator as opposed to a multitude of entities. The Department will also have more direct control over the practices of those who are involved in student loan collection.

I recognize that the Department has faced many problems during the past 12 years, primarily due to neglect from the Department's leadership and past administrations. However, the new Department of Education, under Secretary Riley, seems to have been reinvigorated and is ready to face the challenges that direct lending poses. As I can see, the new Department of Education has been more visibly reaching out to solicit information from higher education organizations, universities and colleges and students in order to forge a better relationship and to recognize and rectify the problems and issues these groups have raised.

However, to ensure that direct lending will meet the needs of students, I feel there are a number of areas the Department must address.

(1) The Department must go through some form of public-consultative rulemaking with the higher education community and students so that the implementation of the program is problem-free. The direct lending legislation the House passed would allow the Department to impose these regulations without a formal consultation process. If there is not enough time for a full rulemaking process, it is necessary that the Department create a mechanism for formal consultation with all affected groups.

(2) Students should not be forced to deal with confusion and delays when taking out their loan. When schools choose alternate originators, the Department should insure that the financial aid office is familiar with a clear process for remedying mistakes. This requires training and information. Additionally, the speed and the quality of service should be a criterion in the selection of alternate originators. Students should understand the rules and regulations of the process and they should also know that they can appeal anything. Too many students see the institution as impenetrable and therefore give up on applying for financial aid and thus, often times, their future. If we, as a country, are committed to providing low income students the opportunity to better themselves and thus society through a college education then we must be committed to provide adequate information about the student loan program to students before they enter college, during college, and after graduation when they are repaying their loans.

(3) The Department of Education must take on the task of providing easily understood information to students and must strictly enforce its own rules. The Department currently has a 1-800 number, but many students don't know it exists, the phone line is understaffed and even when the Department takes the side of the student they do not directly intervene. The Department should publicly advertise how borrowers can contact them and must create a student services department that would field the calls in a manner that conveys that the Department cares about students' individual situations. The Department must also utilize its power to directly intervene when a student faces a problem with a collection agency.

(4) Students must be informed of the terms of their repayment options. I know provisions under the 1992 Amendments to the Higher Education Act now require lender and guaranty agencies to inform borrowers of their repayment options beginning July 1993. I am happy that there is some language to this effect in the Student Loan Reform Act of 1993, but I feel it needs to be strengthened. I understand that under the Student Loan Reform Act students will have multiple repayment options, including income contingent loan repayment. This type of loan repayment would help someone like me, since I work for a low-paying, non-profit organization. I know many students who would love to work in non-profit organizations, as teachers, or for other community sensitive jobs, but can not because of the massive debt they incurred while in college and will benefit from lower monthly payments. Yet those who choose this option must be informed that they will face a longer repayment period and will be forced to pay back much more interest than they would under standard repayment. I would like to see regulations requiring the

Secretary to inform borrowers of the amortization schedule, length of repayment, amount of interest and total amount to be repaid for each repayment option. Additionally, language given for income contingent repayment must include such information for a range of income levels.

(5) The Department must strictly enforce its regulations and allow only those with exemplary service to originate and collect student loans. Often today schools and other entities do not abide by the Department's rules and regulations. For example, currently schools are supposed to give every student an "exit interview" to explain their repayment plan. I not only never received such an interview, I had never even heard of such a thing. Under a system of direct lending, the institutions must provide comprehensive exit interviews so that the student is informed of their rights, responsibilities and repayment options. In all steps of the process students should have an institutionalized role in judging the quality of service of those involved with student loans, and the Department should deny contracts to those entities which violate its regulations.

With these recommendations, I hope that the transition to Direct Lending will be of benefit to students across the country, and will help other low income students avoid the problems I had to face when I was in school. Thank you.

Mr. TOWNS. Thank you very much, Ms. Bloomingdale.

I noticed that you indicated that you did not go to the University of Michigan or Emory University or University of New Mexico, because I am certain if you had gone to one of those schools you would have had an exit interview. I am certain.

But let me say, though, that I think in your testimony you raise some very interesting points and something that I must admit that we are struggling with at another level: Allowing a student to go work for a government agency and work some of the loan off. I think that that makes a lot of sense because what happens now is, as we try to reform health care, we are running into a very serious problem. In most countries, you have 30 percent of the doctors specializing and 70 percent as general practitioners and primary care. In the United States, however, we have 70 percent of our doctors specializing. And when you talk with them, the reason a lot of them are specializing is because they have to pay back their loans, since that is the way they make money. And it is like the guy who robbed the bank. The reason he robbed the bank is because that is where the money is. The reason they specialize, is because that is where the money is. That is a very important aspect to consider; how to get people involved in public service and pay off their loans. I think your suggestion is one way to do it.

The other thing that—I guess this is directed to you, Mr. Butts, it seems you feel that there is no reason to phase in direct lending over a period of time.

I think the reason some of us are very nervous about jumping into direct lending is the fact that we heard some of these same arguments about Medicaid that Medicaid would cut costs and Medicaid would save this.

Well, Medicaid has messed up New York. As a result of Medicaid, doctors will not take Medicaid; and, therefore, patients have to go to the emergency room to be treated, which costs 10 to 15 times more than treating them in the emergency room. But doctors will not take Medicaid.

So those of us who have watched these things before, we are a little nervous about jumping in. Even though I know you talked about the possibility of phasing so many colleges in over a period of time, but we still have some reservations about it.

Mr. BUTTS. May I comment on that?

Thank you.

I appreciate your concern. And I would not—I would be opposed to starting this program up for the 1993–94 school year. It couldn't be done. That is why we are taking 5 years to implement it.

If it stays as a pilot program, quite frankly, the people that have been trying to kill this thing will—by the end of 5 years—kill it, in my opinion. The demonstration program that Congress passed last year provides in the 1994–95 school year the same size that is in this phasein program. The Department of Education will have to be tooling up for 1994–95, for the same size program that this new phasein program has. It will grow, then, to 25 percent the next year and so on, until you are finally into full implementation.

My experience comes from being a student financial aid administrator who implemented the Pell grant program at the University of Michigan. Our institution was a lender under the guaranteed

loan program, and simultaneously managed the Perkins loan program and the health professions loan program. You need time to do those things right.

Also, from the point of view of having managed these programs within the Department of Education, in my professional opinion, direct lending can be done.

Mr. TOWNS. Let me just say that the Senate is recommending that we start out with 30 percent, initially.

Mr. BUTTS. I believe the Senate this morning, in the mark up, called for 5 percent, which is roughly the same volume as the House bill. That, then, increased to, I believe, 30 percent or so. And then instead—in the third year it is 40 percent rather than the House version of 60 percent. And they would keep it as a goal of 50 percent of volume for the next 2 years. There is a difference between the two bills.

Mr. TOWNS. That is not my understanding, but let the record reflect that I hope you are right.

Mr. Schiff.

Mr. SCHIFF. Thank you, Mr. Chairman.

Briefly, one question: Ms. Bloomingdale when I was in college—and I don't want to say when that was exactly, but the President and I graduated the same year, and we both have done about the same, don't you think, in those 25 years—we were affiliated with something called the National Student Association.

Is that still around? Or is that a predecessor group that is gone now?

Ms. BLOOMINGDALE. It is a predecessor group, but it is no more. It merged with the National Student Lobby.

Mr. SCHIFF. So it is a separate group from yours?

Ms. BLOOMINGDALE. It sort of merged into ours. That was in 1972.

Mr. SCHIFF. Do you represent a successor organization to that or a different organization?

Ms. BLOOMINGDALE. It is a successor organization.

Mr. SCHIFF. Mr. Chairman, I really have no questions for the panel because I believe they expressed themselves very well.

Just as I recognized your good faith in accepting recommended witnesses from the Republican side of the aisle, I would note that both witnesses testified in support of the administration's plan. I think that would vouch for our good faith. We didn't clear in advance what people might say.

The only other observation I want to make is that it appears to me, especially since this plan is in the Budget Reconciliation Act—and even though that has problems for other reasons—it sounds like this is on a fast track.

And I would like to ask out in the audience: Anyone there from the Department of Education keeping an eye on us here at this hearing?

Good. I would have been extremely disappointed if someone hadn't waved back at me.

You know, what all this comes down to is, based upon a paper model, this should work and save money and be simple and be of more benefit to the students. If that works, I think that the admin-

istration is entitled to all due credit for having pushed this through the Congress.

However, should fortune keep me in the U.S. Congress for a while and on this committee and in this subcommittee, I would hope that if this passes and becomes law—and it looks to me that it will—that we will have another hearing at some point where we can see if all the paper projections came out to be the case. Because just as if the administration is entitled to the credit if this works, I know who is responsible if it doesn't.

And you will back me on that, Mr. Chairman.

Mr. TOWNS. Thank you. Mr. Schiff, we have a statement that was submitted by Dr. Delores Cross of Chicago, and I would like to ask that that be included in the record if there is no objection.

[The statement may be found in the appendix.]

Mr. TOWNS. And let me again thank you for coming. I think the testimony was very powerful.

Also, Sallie Mae also submitted a statement that I would like to include in the record as well, if there are no objections.

[The statement may be found in the appendix.]

Mr. TOWNS. Again, let me thank all four of you for your testimony, because so often there are those of us who are involved on this side in terms of creating these situations and always developing laws who do not talk with people who are involved in implementing them. It is easy to read something, and then say we think that this will work. It makes a difference when we talk to people who are out there, like you, who day in and day out are administering these programs. So your testimony is extremely important to us.

And Ms. Bloomingdale, I empathize with you as one who has just gone through the student lending system and did not get your exit interview. To hear from you and other students is essential to our understanding of the system in practice.

Mr. Butts, the fact that you were with the Department at one time and you were able to see it on their inside evolve in terms of administering the national student loan program, your testimony, too, has been very helpful to us.

I would like to reiterate my deep concern over the Department's ability to manage and implement direct lending. The complexity of the current GSL program is only one of the factors contributing to the Department's poor record of administrating student loans.

All student lending programs—direct lending, GSL, or an alternative—will be complex since they are responsible for administering a $63 billion loan portfolio. I believe that eliminating the complexities of the current system will not improve the system until the Department corrects its poor management and oversight problems, which, I think are the root of the Department's failures. And 5 years from now, it really does not matter who is originating or servicing the student loans if the Department fails to improve its management structure. The key to the Department's success will be highly qualified, competent personnel to install effective information systems, management planning, and solid oversight.

At this time, the committee will conclude. The hearing is over.

[Whereupon, at 1:35 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

Testimony To The

House Subcommittee On Human Resources

Dr. Dolores E. Cross
President
Chicago State University

Thursday, June 10, 1993

I am pleased to provide written testimony in connection with the House Government Operations Subcommittee on Intergovernmental Affairs and Human Resources hearings concerning the impact of President Clinton's proposal to establish a campus-based direct student loan program as a substitute for the current bank-based, federally-guaranteed loan program.

Chicago State University is one of twelve public institutions of higher education in Illinois. We are a comprehensive university composed of four colleges -- Arts and Sciences, Education, Business, and Nursing and Allied Health Professions. Our enrollment is approximately 9,000 undergraduate and graduate students. All of the public universities serve African Americans and other people of color but none as fully as Chicago State University. Approximately one-third of all African American students attending Illinois public universities are enrolled at Chicago State University.

The majority of our students come to college under conditions of economic and academic disadvantage. Many are older, primary caregivers in their families, low-income and often working full-time and attending college full-time. Three-fourths of our students depend on need-based aid. Our FFELP volume is approximately $5.1 million - 1,735 students borrow through that program. In addition, $8.4 million in need-based student aid from other Title IV programs helps Chicago State University students meet the cost of attendance.

Given this level of financial need, it should be clear that any decrease in

aid or any impediment to its timely delivery could make the difference between a student persisting and graduating from college or that student being forced to drop out.

Like many of my colleagues, I have for a long time held a strong commitment to access and equity in postsecondary education and, for that reason, have over the past several months voiced concerns about the potential impact of direct lending on institutions such as Chicago State University, institutions with little or no experience in direct lending and relatively unsophisticated in terms of technology.

Of greater concern to me, however, is the fact that while many people are looking at a direct loan program as a solution to our budgetary problems, in terms of a $4.3 billion deficit reduction over the next five years, no one seems to be talking about a commitment to maintaining or expanding grant aid, particularly the Pell Grant program. When the concept of a direct loan program to replace the Stafford Loan program was first outlined during the Higher Education Act reauthorization process, a year and a half ago, a major selling point was that the savings from not having to pay lenders and guarantors would be put into the Pell program for low-income, high-need students. That appears to no longer be on the table, and no one is even asking about it!

I know that most of the comments to come before this committee relate to the technical aspects of administering a direct loan program, and I do not

mean to minimize the importance of considering how this program will work. However, there needs to be a voice for students and for access, a voice that reminds the technicians that they also need to be looking at what's happening to student aid overall. Direct lending encourages self-help but no one is looking at the grant side, even though the grant-loan balance already has swung too far away from grants, particularly for low-income students. In our haste to examine the technical aspects of a direct loan program, we have moved too far away from the original intent of student aid, which is to remove financial barriers to higher education access.

Yes, we support a direct loan demonstration program, but we also want to see other things addressed. First, and above all, we should be certain that any changes that we make will not disrupt students' lives. Given that one-half of all need-based student aid comes from loans, it should be very clear that we need to look at alternatives, lest we cause a major disruption in higher education access if the direct loan program fails to meet our expectations.

Second, while we are moving toward direct loans, we must be certain to maintain the integrity of the other student aid programs. The underfunding of the Pell Grant program and the cumulative shortfall create too many uncertainties for students who depend on grant assistance to be able to attend college. The buying power of Pell has eroded and appropriations continue to fall short of the authorized maximum award. The result has been that low-income students have been forced to borrow to pay college costs.

Third, I am not alone in my concerns about the administrative capacity of the Department of Education. The Department of Education has never been administratively sophisticated. For many years, college and university officials have felt that the Department needed to strengthen its administrative and organizational capabilities. This need remains. The appointments of Secretary Riley and Deputy Secretary Kunin, and the nomination of Assistant Secretary designate Longanecker, are good, hopeful signs. But much remains to be done. Regardless of whether or not the Congress enacts a program of direct lending, the Department of Education must improve its capacity to administer the federal student aid programs and especially the student loan program on which so many students depend.

Finally, as we look for long-term savings, we also need to plan in the long-term for grants. If this trial should turn out to be a disappointment, either in terms of insufficient savings or administrative complexity, the results could be a loss of access for our most vulnerable students, the poor and the traditionally underserved. We need to reduce the reliance on loans for low-income students and, at the same time, be able to assure them that their financial need will continue to be met.

If this does not happen and if the gap between low-income students' resources and the cost of a college education widens, we could once again, tragically, find ourselves in the circumstances of the 1960's when only those who could afford to pay out-of-pocket could have access to higher education.

STATEMENT OF THE

STUDENT LOAN MARKETING ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON HUMAN RESOURCES AND INTERGOVERNMENTAL RELATIONS

COMMITTEE ON GOVERNMENT OPERATIONS

JUNE 10, 1993

The Student Loan Marketing Association, Sallie Mae, is pleased to have this opportunity to share with the Subcommittee some of our experience in building the private-sector capacity to effectively support America's ever-increasing demand for education credit, and to offer our perspective on the technological, human, and administrative challenges inherent in annually delivering $20 billion of education credit through 10,000 of the Nation's public and private postsecondary institutions.

Sallie Mae, like Fannie Mae or Freddie Mac, is a government-sponsored enterprise (GSE) -- a private-sector enterprise established by Congress to address a public policy need. Sallie Mae was created to provide liquidity and to supply operational and financial products and services which ultimately support the five million students and parents who each year rely upon credit to help finance the costs of higher education. As the Nation's major intermediary to the education credit market, Sallie Mae has successfully raised and delivered private capital to increase dramatically the availability of education credit, and significantly enhance access to it by students and their families. The corporation also provides financing to meet the infrastructure needs of many of America's colleges and universities.

While we are proud of our operational and financial performance over the years and the return it has provided to the many Americans who invest their savings in this business, we are equally proud of our ability to employ private-sector efficiencies to help make the dream of higher education a reality for millions of Americans. In the twenty years since its creation, Sallie Mae has funded loans for more than 23 million students and parents -- or more than $60 billion of education credit.

In fulfilling its distinct public policy mission, Sallie Mae has invested millions of dollars in the systems, technology, and human resources necessary to enhance access to education credit and strengthen the market's supply of private capital to support that credit. In the process, we have worked in partnership with thousands of lenders, thousands of schools, and millions of students and parents to help support the private capital-based Federal Family Education Loan program, formerly known as the Guaranteed Student Loan Program (GSLP).

As you know, the Administration has proposed phasing out the GSLP and replacing it with a system of direct federal lending that would be administered by the Department of Education, funded through U.S. Treasury borrowing, aided in loan collections by data supplied through the Internal Revenue Service, and supported by a range of fee-for-service government contractors who would be

responsible for executing many of the key direct lending functions.

As you also are well aware, Sallie Mae questions the public policy wisdom of the federal government's committing to dismantling the current, 25-year-old student loan system in favor of direct lending before assessing the results of a direct loan pilot program that was just authorized by Congress last summer and yet to be implemented by the Department of Education.

What is perhaps less obvious is that Sallie Mae supports -- and has so stated in numerous public and private forums -- the Administration's and Congress's desire to streamline the student loan program, institute a program of national service, reduce borrower defaults and taxpayer costs, and ease the repayment burden for students and parents. We supported the reform measures implemented by Congress last year that are intended to address many of these same concerns. During the recent student loan funding debate, we also have provided the Administration and Congress a set of reform proposals which would achieve many of these policy objectives quickly, within the existing system, and within the budget savings targets outlined in the reconciliation process.

Under direct lending, we believe that significant programmatic, administrative, and technical issues will represent

both near-term and long-term obstacles to success. The issues include:

- Will schools or the government contractors envisioned in the current legislation be able to originate loans under the proposed $10 and $20 origination fee? Our own costs, as an industry leader benefitting from economies of scale, are nearly $40 per loan. What are the consequences to student service level and fiscal control of procedures which are scaled back to tie to the low level of reimbursement?

- The Department's eight-year inability to implement the National Student Loan Data System authorized by Congress in 1986 indicates the complexity of developing the technological resources necessary for effective program monitoring and oversight. How will the Department develop or acquire sufficient systems capacity for the increased oversight demands that will result from direct lending?

- Given the investments we have made in hiring, training, and retaining a national staff to handle complex loan servicing and other programmatic requirements -- coupled with enormous, ongoing investments in designing and purchasing state-of-the-art technologies -- we wonder whether the Department has made realistic projections of the costs and number of contract management, systems, data processing, and enforcement staff needed to implement direct lending.

- Over the past several years, Sallie Mae and others in the student loan community have made innumerable, costly improvements to our loan servicing systems to enhance customer service levels for student and parent loan borrowers and schools. How will the Department balance the marketplace demand for even further advances in the provision of customer service with the federal government's imperative to minimize costs and the statutory caps on the administrative expenses under which the government must operate? Further, how will the Department of Education ensure that customer service levels do not stagnate for the length of the contract period? Finally, how can the Department ensure that inevitable contract modifications will not dramatically increase federal costs?

- As we understand the Administration's plans, schools that elect not to act as loan originators will be assigned an origination agent by the Department of Education. This differs widely from the current program, where schools can exercise a good deal of choice in selecting the private sector lenders from which their students obtain loans. How does the Department intend to ensure that all schools receive the same levels of service quality and what mechanisms will it have in place to protect schools from diminished quality levels? And, even if such a mechanism is in place, how quickly will the Department be able to react to complaints from schools and what sort of leverage will it have over contractors locked into long-term government agreements?

Finally, mention should be made of a specific provision in the Administration's bill for a study of privatization of Sallie Mae. Privatization is not a completely accurate reference since Sallie Mae at the present time already raises all of its capital in the private markets and has most of the attributes of a fully private corporation, including payment of its full share of federal income taxes. The remaining links to the federal government and a federal charter nonetheless qualify Sallie Mae to be among a handful of government-sponsored enterprises, the so-called GSEs.

Now would be an appropriate time to sever Sallie Mae's remaining government ties, both for the benefit of the U.S. government and for the benefit of those who have invested their capital in Sallie Mae. The benefits which would flow to the government from such a conversion relate to the removal of the implicit guarantee which most suggest applies to all GSEs. While there is no explicit guarantee, an assumption is generally made

that the federal government implicitly backs GSE indebtedness. The conversion to a state-chartered corporation would entail a process by which those implicit guarantees could be removed. Sallie Mae, on the other hand, would be able, as a result of the conversion, to participate fully in the education credit field.

We believe that GSEs perform a valuable and useful function in facilitating important national objectives. Certainly Sallie Mae over its twenty-year history has provided billions of dollars of private capital in support of national education objectives, and in the process has benefitted millions of students. The corporation is a vital and highly regarded financial institution. Its resources can be adapted and deployed in continuing to support education credit and related activities in a non-GSE setting. Recent proposals to implement a direct lending plan argue for acceleration of efforts to change Sallie Mae's status so that it can perform these essential activities.

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